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Supreme Court, U.S.
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In The
Supreme Court of the United States

OCTOBER TERM, 1985

NORTHWEST CENTRAL PIPELINE CORPORATION and K N ENERGY, INC.,

Appellants,

VS.

THE STATE CORPORATION COMMISSION OF THE STATE OF KANSAS, et al.,

Appellees.

ON APPEAL FROM THE SUPREME COURT OF KANSAS

JURISDICTIONAL STATEMENT

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QUESTIONS PRESENTED

1. Whether the ruling of the Kansas Corporation Commission that is designed to cause interstate pipelines to purchase more natural gas from Kansas and less natural gas from other states violates the exclusive authority of the Federal Energy Regulatory Commission (i) to regulate the cost structures of interstate gas pipelines, and (ii) to control and regulate abandonments of natural gas dedicated to interstate commerce, in violation of the Supremacy Clause of the United States Constitution.

2. Whether the ruling of the Kansas Corporation Commission is designed to cause large volumes of natural gas previously dedicated to interstate commerce to be diverted by force of Kansas law to the Kansas intrastate market constitutes impermissible state regulation of interstate commerce in violation of the Supremacy and Commerce Clauses of the United States Constitution.

PARTIES TO THE PROCEEDING

In addition to the parties named in the caption, Amoco Production Company, and Colorado Interstate Gas Company were appellants together with Northwest Central Pipeline Corporation before the Supreme Court of Kansas. Michael Lennen, Chairman, Richard D. (Pete) Loux, Commissioner, and Phillip R. Dick, Commissioner, and their respective successors, Margalee Wright and Keith P. Henley, of the State Corporation Commission of the State of Kansas, appeared in opposition to Northwest Central Pipeline Corporation before the Supreme Court of Kansas.

The following companies also appeared before the State Corporation Commission of the State of Kansas at the initial proceeding:

Southwest Kansas Royalty Owners Association
Mobil Oil Corporation
Northern Natural Gas Producing Company
Federal Land Bank of Wichita
Anadarko Production Company
Northern Natural Gas Company
El Paso Natural Gas Company
Mesa Petroleum Company
Kansas Power and Light Company
Cabot Petroleum Corporation
Northern Pump Company
Graham-Michaelis Corporation
Kansas Petroleum, Inc.
Panhandle Eastern Pipeline Company

Kansas-Nebraska Natural Gas Company
Arco Oil and Gas Company
Cities Service Company

Affiliates of Northwest Central Pipeline Corporation and of K N Energy, Inc., are listed in Appendix I to this Jurisdictional Statement.

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NORTHWEST CENTRAL PIPELINE CORPORATION and K N ENERGY, INC.,

Appellants,

vs.

THE STATE CORPORATION COMMISSION OF THE STATE OF KANSAS, et al.,

Appellees.

ON APPEAL FROM THE SUPREME COURT OF KANSAS

JURISDICTIONAL STATEMENT

Northwest Central Pipeline Corporation (Northwest Central) and K N Energy, Inc. make this appeal from the judgment of the Kansas Supreme Court, entered on May 10, 1985, upholding a regulation and order of the State Corporation Commission of the State of Kansas in the face of federal constitutional challenges. Appellants submit this statement to show that the Supreme Court of the United States has jurisdiction over the appeal and that a substantial question is presented.

OPINIONS BELOW

The opinion of the Kansas Supreme Court (App. A, *infra*, la - 40a) is not reported. The opinion of the District Court of Gray County, Kansas (App. B, *infra*, 41a - 50a) is not reported. The orders of the Kansas Corporation Commission dated February 16, 1983 (App. C, *infra*, 51a - 68a) and April 18, 1983 (App. D, *infra*, 69a - 80a) are not reported.

JURISDICTION

This case involves a challenge to the constitutionality of an amendment to Paragraph (p) of the Kansas Corporation Commission's Basic Proration Order for the Kansas-Hugoton Gas Field. The Kansas Supreme Court entered its judgment upholding the challenged amendment on May 10, 1985. The jurisdiction of this Court is invoked under 28 U.S.C. § 1257(2). *Atchison, Topeka & Santa Fe Railway* v. *Public Utilities Commission*, 346 U.S. 346, 348 (1953).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The pertinent provisions are set forth in App. G, *infra*, 86a - 92a.

STATEMENT OF THE CASE

The Hugoton Gas Field is said to be the largest known reservoir of natural gas in the world. The Field,

as developed, is approximately 160 miles long and from 40 to 72 miles wide. It covers portions of nine counties in Kansas (Kansas-Hugoton) and extends across the entire width of the Oklahoma panhandle (Guymon-Hugoton) and into portions of several counties of northern Texas (Texas-Hugoton). About two-thirds of the Field is located in Kansas. In 1983, there were in excess of 4000 wells located in the Kansas portion of the Hugoton Gas Field.

Most of the gas produced from the Kansas-Hugoton Gas Field is transported through large pipelines to other states, including Michigan, Minnesota, Ohio, Illinois, Indiana, Missouri, Colorado and Nebraska. Much of the gas produced from the Oklahoma and Texas portions of the Field is similarly transported through the same large pipeline systems for use in these states. Gas from the Kansas-Hugoton Gas Field is commingled in the integrated pipeline system with gas produced from various other fields in other states.

Five major interstate pipelines — Northwest Central Pipeline Company, Northern Natural Gas Company, Panhandle Eastern Pipe Line Company, K N Energy, Inc., and Colorado Interstate Gas Company — have acquired the right to purchase the gas produced from approximately 90 percent of the Kansas-Hugoton wells. *Colorado Interstate Gas Co.* v. *State Corporation Commission,* 192 Kan. 1, 4-7, 386 P.2d 266, 270-271 (1963). The connected reserves of the interstate purchasers in

the field are a significant part of their total system-wide reserves[1].

In 1935, the Kansas legislature enacted a statute entitled "Production and Conservation of Natural Gas." 1935 Kan. Sess. Laws, Ch. 213 (*codified as amended at* Kan. Stat. Ann. § 55-701 *et seq.*). Section 55-703 provides: "[T]he [Kansas Corporation] Commission shall regulate the taking of natural gas from any and all such common sources of supply within this state in order to prevent the inequitable or unfair taking of natural gas from a common source of supply by any person, firm or corporation and to prevent unreasonable discrimination * * * in favor of or against any producer in any common source of supply." The purpose of the statute was to modify the so-called "rule of capture" in order to ensure that the several owners of mineral interests in a single field (or "common source of supply") each may receive a fair and equitable portion of the oil and gas available to be produced from the field.

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[1] The importance of these reserves to the pipeline companies is evidenced by the fact that the field has long been a spawning ground for litigation. Much of this litigation has resulted from the Kansas Corporation Commission's historical efforts to intrude upon the federal agency's exclusive jurisdiction under the Natural Gas Act, ranging from increasing the price of natural gas at the wellhead by its minimum price orders (invalidated under *Cities Service Gas Co.* v. *State Corporation Commission*, 355 U.S. 391 (1958)), to more recently requiring the pipeline purchasers to take ratably, when the result might be a readjustment of pipeline purchasing patterns from state to state (invalidated under *Northern Natural Gas Co.* v. *State Corporation Commission*, 372 U.S. 84 (1963)).

Acting pursuant to this statutory authority, on March 21, 1944, the Kansas Corporation Commission adopted the Basic Proration Order for the Hugoton Gas Field. The Basic Proration Order provides limits, or "allowables," for production for each well located in the Kansas-Hugoton Field. Paragraph (p) of this Order historically has provided that any well must be "shut in" (and production thus curtailed) if the well has overproduced its allowable by a cumulative amount equal to six times its allowable for the month of January. Paragraph (p) has also provided that if any well has fallen short of producing its allowable by a cumulative amount equal to six times its monthly allowable, this shortfall will be cancelled and the producer prohibited from later making up the shortage. Until the recent action of the Kansas Corporation Commission that gives rise to this appeal, however, Paragraph (p) had further provided that these "cancelled underages":

> "* * * will be reinstated upon verified application therefore, showing that the wells are in an overproduced status; that the purchaser is willing and able to take the amounts of gas; and that the length of time proposed by applicant for the production of the amounts of gas to be reinstated is reasonable under the circumstances." App. H, *infra,* 113a.

Since 1963, the Kansas Corporation Commission has attempted to increase the volume of production from the Kansas portion of the Hugoton Field by fixing production allowables far in excess of the market demand

for natural gas. That is, the Commission has set allowables far in excess of what producers can produce and sell into the interstate natural gas market. The result has been that huge "underages" have developed for most wells connected to interstate pipelines in the Field. The wells connected to Northwest Central provide a typical example of the production status for the interstate pipelines, which have witnessed a plummeting interstate gas market. As of June 1985, the wells in the field connected to Northwest Central are carrying an underage of almost 91.6 billion cubic feet. By contrast, at least one major intrastate pipeline has had sufficient in-state market demand to allow its connected wells to continue in an overproduced status.

The Order of February 16, 1983, amended Paragraph (p) of the Basic Proration Order to provide that underage cancelled before 1975 could be reinstated only if reinstatement had been requested by the end of 1983. The Amended Paragraph (p) further provided that underages cancelled from January 1, 1975, through December 31, 1982, could only be reinstated if reinstatement was requested by December 31, 1985, and only if the well was in an overproduced status at the time of the request. Finally, with respect to underages cancelled after December 31, 1982, the amendment to Paragraph (p) requires that the producer must seek reinstatement of the cancelled underages within three years of the cancellation and further requires that the well must be in an

overproduced status at the time of the request. The objectionable part of these amendments to Paragraph (p) is that if the underage is not reinstated within the given periods or if the reinstated underage is not produced within the time permitted by the Corporation Commission, the underage is to be *permanently cancelled* and the affected pipeline thus precluded from purchasing all the reserves dedicated to it by contract in the Field.[2]

The evidence adduced before the Corporation Commission and the District Court revealed that wells with a higher proportionate *intrastate* market demand have been able to produce a greater proportionate part of their gas reserves than the majority of the wells in the Field connected to the *interstate* pipelines like Northwest Central. App. A, *infra,* 38a. The direct and immediate result of the permanent cancellation by the Corporation Commission of the interstate pipelines' right to take their proportionate share of gas from the

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[2] The permanent cancellation of underage would cause a loss of reserves in the situation where migration of reserves to adjacent or nearby overproduced wells occurs that is not later offset by compensating cross migration of reserves back to the affected well. Although the question whether this loss of reserves will occur with respect to any single well would require a detailed factual analysis of the circumstances of that well and its surrounding wells, it is clear that this effect will occur with respect to a significant number of wells in the Hugoton Field. *See* App. A, *infra,* 12a, 21a. *See also id.* at 38a (Schroeder, C. J., dissenting) ("the result of cancellation under this order will be to * * * no longer permit the corrective or compensatory drainage which was the hallmark of the prior commission order for years. KP&L's intrastate customers will benefit, and Northwest Central interstate customers will be prejudiced.").

Kansas-Hugoton Gas Field is that, under existing circumstances, significant volumes of gas dedicated to interstate commerce will be diverted by force of Kansas law to the Kansas intrastate markets rather than being produced into interstate commerce. *See* note 2, *supra.*

The purpose of the Kansas order, as has been admitted by the Commission's staff in the record below, is to coerce interstate pipeline purchasers to produce greater volumes of gas from the Kansas Field (R. Vol. 9, p. 17). And the Commission has sought to accomplish this objective even though they recognize that this could necessarily result in these pipelines purchasing less gas from sources in other states (R. Vol. 9, p. 94) and would also necessarily subject these pipelines to contract liability and penalties if they fail to perform their purchase contracts in other states (R. Vol. 9, p. 96). The Commission has, in fact, admitted that by this Order it has intended to assume the authority to dictate how much gas the pipeline purchasers must take in Kansas and, thus, how much of their remaining purchases the pipelines may make in other states (R. Vol. 9, p. 48).

Northwest Central contested the Corporation Commission's proposal to amend Paragraph (p) at hearings held before the Commission on November 3, 1982, and March 17, 1983. The Corporation Commission ruled, however, that "[t]he contention that the Commission's order of February 16, 1983, changing the provisions of Paragraph (p) of the Hugoton basic order invades the

exclusive jurisdiction of the FERC under the Natural Gas Act is without merit." App. D, *infra*, 74a - 75a.

Northwest Central appealed the Corporation Commission's order to the District Court of Gray County, Kansas, arguing that the order invaded the exclusive domain of the Federal Energy Regulatory Commission under the Natural Gas Act and impermissibly regulated and burdened interstate commerce. The district court ruled that the order would provide an incentive for gas pipelines to take more gas from the Kansas-Hugoton Gas Field, and that the order would pressure interstate pipelines to alter their purchasing patterns in order to take more gas from Kansas and less gas from other states. The district court nevertheless held that, because the order was expressly directed at producers of natural gas, the order was within the "producing or gathering" exemption in the Natural Gas Act.

Northwest Central appealed the district court decision to the Supreme Court of Kansas where it argued that the order's actual and intended effect of inducing pipelines to purchase more gas from Kansas violated FERC's exclusive jurisdiction to regulate the cost structures of gas pipelines, and constituted an unconstitutional interference with interstate commerce. The Kansas Supreme Court erroneously held that, although the order is obviously intended to regulate the affairs of the pipeline purchasers, still the order is directed to pro-

ducers. The court stated:

> "Hence, the question which this court must decide is whether this indirect effort to influence purchasers meets the standards noted in *Northern Gas,* which would preclude State regulation in this area. As stated in *Northern Gas,* federal regulation does not apply to the production or gathering of natural gas. Interpreted in a narrow sense, as suggested by *Northern Gas,* the matter of allowables must be construed to pertain to production. The state has regulatory authority over production. The rules on underages are a part of production regulation and thus are not violative of the federal act, even though purchasers are indirectly caught in the backwash." App. A, *infra,* 28a - 29a.

THE QUESTIONS ARE SUBSTANTIAL

I. DOES PARAGRAPH (p) AS AMENDED BY THE KANSAS CORPORATION COMMISSION INVADE THE EXCLUSIVE JURISDICTION OF THE FEDERAL ENERGY REGULATORY COMMISSION?

In *Northern Natural Gas Co.* v. *State Corporation Commission,* 372 U.S. 84 (1963), this Court held that a Kansas regulation that interfered with the exclusive federal authority to regulate the cost structure of interstate pipelines was invalid under the Supremacy Clause. The Court held in *Northern Natural* that no individual State could regulate or direct the purchase practices of interstate pipelines, because such authority had exclusively been made the province of federal regulation under the Natural Gas Act, 15 U.S.C. § 717, *et seq.*

The broad-based implications of the Kansas Corporation Commission's Regulation that is challenged on this appeal, and the resulting Kansas Supreme Court decision upholding it, are readily apparent. If the Kansas regulation which encourages production from Kansas at the expense of other states is found constitutional, other states will surely soon follow Kansas' lead. FERC authority to regulate the sale and transportation of gas in interstate markets would be circumvented by discriminatory laws or regulations enacted by the individual states for purposes of promoting the individual state's gas production and protecting it from competitive gas sources outside the state.

Such piecemeal regulation by the states quite plainly impinges upon the exclusive authority of FERC. The need for paramount federal authority is compelling because the state agency would regulate in the state interest, rather than national interest. Not only is there potential for such protectionism among the states, indeed, we are already witnessing the burgeoning of such regulations. In addition to Kansas, two other states, Mississippi (Miss. State Oil and Gas Board, Order No. 409-82, Oct. 13, 1982) and Oklahoma (Corp. Comm'n of the State of Okla., Order No. 281285, July 3, 1985), have already taken the position that they have authority to regulate interstate pipeline purchases of gas from their respective states notwithstanding FERC regulation under the Natural Gas Act. The unavoidable conflict

between producing and consuming states makes the desirability of uniform federal regulation abundantly clear. *Public Service Commission* v. *Federal Energy Regulatory Commission*, 610 F.2d 439, 443 (6th Cir. 1979).

1. In the proceedings below, the district court found, as a matter of fact, that the Kansas Commission's order would have two important effects on the interstate pipelines purchasing gas from the Kansas-Hugoton Gas Field (App. B, *infra*, 46a (emphasis supplied)):

> "As a practical matter, the change in 'P' will cause some *permanent loss* of underages (allowables) due to market conditions and will also cause a *change in the 'mix'* of natural gas which pipelines transport for sale many miles away."

These consequences of the Kansas Commission's Order place the Order squarely within this Court's rulings that prohibit the States from regulating the purchase practices of interstate pipelines because such regulation invades the FERC's exclusive jurisdiction to regulate the cost structure that exists between interstate gas pipelines and interstate gas consumers. *Northern Natural Gas Co.* v. *State Corporation Commission*, 372 U.S. 84 (1963).

The Kansas Supreme Court, however, held that the Kansas Commission's order did not interfere with FERC's exclusive authority to regulate interstate pipelines on the theory that the order applies only to "pro-

duction or gathering" of natural gas (App. A, *infra*, 28a - 29a). It is true that the Natural Gas Act does not confer jurisdiction to the FERC over "the production or gathering of natural gas." 15 U.S.C. § 717(b). But, under the rulings of this Court and the record below, it is evident that the Kansas order, both in its purpose and in its actual effect, regulates pipelines and is not limited to "production and gathering" of natural gas. Indeed, the admitted purpose of the order is to compel interstate pipelines to purchase large quantities of Kansas-Hugoton gas in a very short time period, or to lose forever their right to take such gas. The Kansas Commission's staff witness admitted that the order had the specific intent to change the purchasing patterns of pipelines (see page 8, *supra*), and the district court specifically found that, indeed, the order quite plainly *would* have that effect. App. B, *infra*, 46a.

The Kansas Commission's order was based on the Commission's finding that: "The evidence clearly demonstrates that [the preexisting] Paragraph P does not provide operators sufficient incentive to produce gas." App. D, *infra*, 61a - 62a. The evidence cited by the Commission to support this finding was the fact that actual production had fallen far behind the maximum allowable production in the Field. App. C, *infra*, 62a. It requires no sophisticated analysis, however, to understand that *operators need no incentive to produce and sell gas.* Any operator will sell as much gas as a pipeline will take.

There is *no* evidence in the record to suggest that gas well operators have ever been unwilling to sell the maximum allowable in gas production. The record is replete with evidence, however, that gas pipelines have been unable to take the inflated Kansas allowables for Kansas-Hugoton gas and still comply with their contractual gas purchase obligations in other states. App. A, *infra*, 22a. Therefore the only purpose and effect of the challenged order is to compel interstate pipelines to take more gas from Kansas-Hugoton Field at the expense of production in other states.

The Kansas Commission's order is thus clearly not a mere "production or gathering" regulation, but is instead a regulation designed exclusively to affect the purchasing patterns of gas pipelines. The order is *not* designed to regulate the activities of producers; instead, it is designed and intended to regulate the purchasing patterns of interstate pipelines.

The Kansas Supreme Court itself recognized the implausibility of the contention that the Kansas Commission's order dealt solely with "production or gathering" of gas. The Court stated: "The order in the instant case gives us pause. *It obviously is intended for purchasers*, but is directed to producers * * *." App. A, *infra*, 28a (emphasis added). The court simply concluded, however, that "[i]nterpreted in a narrow sense, as suggested by *Northern Gas*, the matter of allowables must be construed to pertain to production." *Id.* at 29a. But Chief

Justice Schroeder, in his dissent, exposed the fatal defect in the Kansas Supreme Court's analysis (*id.* at 34a):

> "Although the commission contends that its order is directed at producers not purchasers, its real purpose is to create an impact on purchasers' business decisions concerning the makeup of their interstate gas mix, with an eye toward making it economically prohibitive for such purchasers not to purchase increased substantial volumes of gas from the Kansas Hugoton Field even at the expense of their purchases from other states."

Given these facts, it is impossible to understand the reasoning behind the Kansas Supreme Court's holding that the Kansas Commission's order relates merely to "production and gathering" of gas[3]. The order is in fact a regulation of interstate pipelines that has the precise effect of altering these pipelines' cost structures that was forbidden by this Court in its decision in *Northern Natural Gas Co.* v. *State Corporation Commission, supra,* 372 U.S. at 91-92. The mere fact that some of

[3] The production or gathering exemption has been strictly construed by this Court. The terms "production and gathering" have been narrowly confined to the physical acts of drawing gas from the earth and preparing it for the first stages of distribution. *Northern Natural Gas Co.* v. *State Corp. Commission,* 372 U.S. 84, 90 (1963). Although FERC has no jurisdiction over drilling and spacing and the like, *Colorado Interstate Gas Co.* v. *Fed'l Power Comm'n.,* 324 U.S. 581 (1945), it does have jurisdiction over the sale of natural gas in the interstate commerce, even though such sale may occur before production and gathering is ended. *United Gas Improvement Co.* v. *Continental Oil Co.,* 381 U.S. 392 (1965). Cancellation of allowables, particularly where those allowables were in excess of actual requirements and the cancellation itself is specifically designed as a prod to affect pipeline purchasing practices and to require pipelines to purchase more gas from Kansas, hardly fall into the limited classification of "drilling and spacing and the like," or the "physical activities, processes and facilities of production and gathering."

the incidences of the order relate to production and gathering does not bring the order into the ambit of the exemption where the order impacts directly or indirectly upon transportation and wholesales of natural gas in interstate commerce. See *id.* at 606; *Public Service Commission* v. *Federal Energy Regulatory Commission,* 610 F.2d 439, 444 (6th Cir. 1979).

2. Once it is determined that the Kansas Commission's order does not fall within the "producing or gathering" exception to the Natural Gas Act, the conclusion is inescapable that the order invades the FERC's exclusive jurisdiction "to regulate the intricate relationship between the purchasers' cost structures and eventual costs to wholesale customers." *Northern Natural Gas Co.* v. *State Corporation Commission, supra,* 372 U.S. at 92.

Both the district court and the Kansas Supreme Court recognized that the Kansas Commission's order would cause a substantial readjustment of purchasing patterns among interstate pipelines. App. A, *infra,* 27a; App. B, *infra,* 46a. This type of state regulation is precisely the kind of regulation this Court held impermissible in *Northern Natural.* Natural gas must be sold contemporaneously with its delivery to a pipeline because it cannot be stored in tanks. Accordingly, gas cannot be purchased in excess of the gas market demand. Increased takes from the Kansas-Hugoton Gas Field

therefore necessarily cause decreased takes from other gas fields. Such decreased takes from other more recently developed natural gas fields, most of which are in states other than Kansas, may impose significant contractual take-or-pay liabilities against the interstate pipelines.[4] In addition, the rapid depletion of older, low-cost Hugoton gas will result in less Hugoton gas being available in the future, causing sharp increases in gas costs in future decades. Depletion of the huge Hugoton Field may, in fact, jeopardize the stability of national gas prices in the future by reducing the existence of proven reserves.

Whether these or other consequences will flow from the Kansas Commission's order is not a matter of certainty. It is certain, however, that the Kansas Commission's order, if allowed to stand, will impair the FERC's ability to control that intricate balance between gas supplies and demands, which is the very purpose for FERC's existence. The Kansas Commission's order threatens to nullify the carefully crafted scheme of interstate gas regulation. It is thus an obstacle to federal control of

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[4] Gas sale contracts often provide that the pipeline will either take and pay for a certain minimum quantity of gas each year or, if that minimum quantity is not taken, will nonetheless pay *as if* the gas had been taken. Such contract clauses are referred to as "take-or-pay" clauses. Requiring a pipeline to increase its purchases ("takes") in one state therefore may well lead to increased "take-or-pay" liability when purchases are necessarily reduced in other states.

the interstate gas market and, for this reason, must be invalidated. "The federal regulatory scheme leaves no room either for direct state regulation of the prices of interstate wholesales of natural gas, or for state regulation, which would produce the same result * * *." *Northern Natural Gas Co.* v. *State Corporation Commission, supra,* 372 U.S. at 91.[5]

3. Under existing circumstances, the Kansas Commission's order will also cause the permanent loss by some interstate pipelines of their rights to purchase significant quantities of gas that have been dedicated to interstate commerce and that the FERC has not authorized to be abandoned under the Natural Gas Act. *See* note 2, *supra.* This aspect of the order strikes at the very heart of the FERC's exclusive authority under Section 7(b) of the Natural Gas Act, 15 U.S.C. § 717f(b). This Section provides that gas dedicated to interstate commerce by interstate pipelines may not be withdrawn from interstate movement without FERC approval. *Sunray Mid-Continent Oil Co.* v. *FPC,* 364 U.S. 137

[5] See also Brief for the United States and the Federal Energy Regulatory Commission in *Transcontinental Gas Pipe Line Corp.* v. *State Oil and Gas Bo ırd,* No. 84-1076, *prob. juris. noted,* 85 L. Ed. 2d 140 (March 25, 1985), which notes (at p. 22) that a state rule that seeks to regulate or affect the purchasing practices and decisions of interstate pipelines is invalid because it "frustrates the ability of pipelines to minimize gas costs and limits the Commission's authority to monitor pipeline purchasing practices * * *."

(1960); *California* v. *Southland Royalty Co.*, 436 U.S. 519 (1978).

The Kansas Supreme Court recognized that interstate pipelines like Northwest Central will probably be physically unable to take sufficient quantities of gas to prevent cancellations of some underages with a resulting effect on dedicated reserves. The court noted that "History indicates market changes sufficient to make up underages have taken six to ten years." App. A, *infra*, 7a. Yet, the Kansas Commission's order mandates that a well must be in an overproduced status before any cancelled underage may be reinstated, and further exacerbates this problem by requiring any reinstated underage to be produced within five years. App. C, *infra*, 67a - 68a. The Kansas Supreme Court skirted the problem by saying: "The weight and logic of the evidence raises serious questions of the producers' ability to persuade the purchasers to take enough additional gas to acquire an overproduced state in time to avoid permanent cancellation of underages. However, there is substantial competent evidence in the record indicating otherwise under *ideal* circumstances." App. A, *infra*, 25a (emphasis added).

It is unnecessary to speculate as to whether "ideal" conditions will permit the purchasers to avoid permanent cancellation of underages and a resulting forced abandonment of dedicated reserves. There is undoubted-

ly an "imminent possibility of collision" between the Kansas Commission's order and the federal scheme of regulation. *Northern Natural Gas Co.* v. *State Corporation Commission, supra,* 372 U.S. at 92. For this additional reason, the Kansas order is therefore invalid under the Supremacy Clause.

II. DOES PARAGRAPH (p) AS AMENDED BY THE KANSAS CORPORATION COMMISSION CONSTITUTE AN IMPERMISSIBLE BURDEN ON INTERSTATE COMMERCE?

Aside from preemption concerns, the Kansas Commission's order impermissibly burdens interstate commerce since its purpose is to secure a larger share of the interstate gas market for gas produced from the Kansas-Hugoton Gas Field at the expense of out-of-state producers. This sort of economic protectionism is flatly prohibited by the Commerce Clause.

1. This Court held in *Pennsylvania* v. *West Virginia,* 262 U.S. 553 (1923), that a state law that obstructs or burdens transmission of natural gas from one state to another is a prohibited interference with interstate commerce. The Kansas Commission's order is specifically designed to obstruct interstate commerce by compelling interstate pipelines to adjust their customary purchasing patterns to buy more Kansas-Hugoton gas, at the peril of losing their dedicated gas reserves to the intrastate markets which, on balance, have already achieved

an overproduction of Kansas-Hugoton gas App. A, *infra*, 34a. A state may not legitimately seek to protect its citizens by placing itself in a position of economic superiority, ignoring problems common to all and forcing others to bear the burden of its regulations. *Philadelphia* v. *New Jersey*, 437 U.S. 617 (1978).

2. The Kansas Commission's order fails to satisfy the constitutional test articulated in *Pike* v. *Bruce Church, Inc.*, 397 U.S. 137 (1970):

> "Where the Statute regulates even handedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld* * *."

397 U.S. at 142.

First, the Kansas Commission's order does not regulate even-handedly. The evidence showed that the intrastate pipelines in the Kansas-Hugoton Gas Field had, on balance, achieved current overproduction at the time the order was entered, whereas the interstate pipelines had huge deficiencies to make up before they could even begin to take cancelled underages. As the dissenting opinion pointed out below, the effect of the order as promulgated would be "to cement for all time that discrimination * * *. [Kansas Power and Light Company's] intrastate customers will benefit, and Northwest Central['s] interstate customers will be prejudiced." App. A, *infra*, 38a.

Second, the Kansas Commission's order does not

seek to serve a legitimate local interest.[6] The effect of the order will be to withdraw a large volume of low-cost natural gas from the established stream of interstate commerce to benefit preferentially the customers of the local intrastate gas companies. App. A, *infra*, 22a - 23a. The cancellation of the right to take Kansas-Hugoton gas for delivery to interstate customers is as pernicious as the prohibited attempt in *Pennsylvania* v. *West Virginia*, 262 U.S. 553 (1923), to force interstate pipelines to siphon gas directly to local customers.

Third, the Kansas Commission's order will have a profound effect on interstate commerce. The courts below recognized that the effect of the order would be to disrupt interstate purchasing practices by increasing the proportion of gas purchased by interstate pipelines from Kansas-Hugoton. App. A, *infra*, 27a; App. B, *infra*, 46a. Pipelines will also be faced with the Hobson's choice of losing the right to purchase gas in Kansas, or of pay-

---

[6] The amended regulation in fact interferes with the traditional state objective of assuring a fair allocation of production to each interest owner in the Field. The Supreme Court of Kansas, after reciting in great detail the lack of equity that will result in the Field, noted "After careful consideration, we are led to the conclusion the KCC's new definition of correlative rights is incorrect. It ignores both K.S.A. 55-703 and K.A.R. 82-3-101(15). There the emphasis is on preventing the inequitable and unjust taking of natural gas from a common source of supply with the objective of providing a way for each developed lease to ultimately produce the gas underlying it. The statutory reference to 'currently produce' must be interpreted with the rest of the sentence. It is then apparent the legislature ordered current production to be proportionate with other leases in the pool, without drainage, to attain equity." App. A, *infra*, 13a - 14a.

ing for gas not taken pursuant to gas purchase contracts entered into by pipelines in other states for newer reserves during the peak of market demand.

In sum, the attempt by Kansas to alter the interstate gas market to favor its own gas production at the expense of other states, interstate pipelines and interstate gas consumers violates the Commerce Clause of the United States Constitution and threatens to disrupt the national gas market by encouraging other states to retaliate, to the ultimate detriment of the national interest.

III. DISPOSITION OF THIS APPEAL WILL REQUIRE CONSIDERATION OF THIS COURT'S DECISION IN *TRANSCONTINENTAL GAS PIPE LINE CORP.* v. *STATE OIL AND GAS BOARD.*

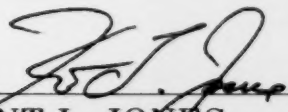
The issues presented in this case are directly related to the issues being addressed by this Court in *Transcontinental Gas Pipe Line Corp.* v. *State Oil and Gas Board,* No. 84-1076, *prob. juris. noted,* 85 L. Ed. 2d 140 (March 25, 1985). In the *Transcontinental* case, this Court has before it the question whether a Mississippi order that requires interstate pipelines to purchase additional gas in Mississippi — necessarily with the result of decreased purchases in other states — is invalid under the Commerce and Supremacy Clauses and as an interference with the exclusive authority of the FERC over pipeline

purchasing practices. Since disposition of the *Transcontinental* case may well affect the outcome of the present appeal, probable jurisdiction should be noted in order to apply the principles of the *Transcontinental* decision to this case.

CONCLUSION

Probable jurisdiction should be noted.

Respectfully submitted,



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I hereby certify that three copies of the foregoing Jurisdictional Statement were mailed, postage prepaid, this 20 day of August, 1985, addressed to the following:

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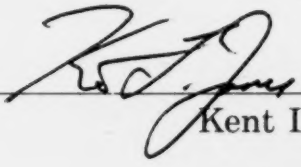

Kent L. Jones

APPENDIX A

No. 56,917

NORTHWEST CENTRAL PIPELINE CORPORATION;
KN ENERGY, INC.;
AMOCO PRODUCTION COMPANY; and
COLORADO INTERSTATE GAS COMPANY,
Appellants,

v.

THE STATE CORPORATION COMMISSION OF THE STATE OF KANSAS,
MICHAEL LENNEN, Chairman,
RICHARD D. (Pete) LOUX, Commissioner,
PHILLIP R. DICK, Commissioner,
and their respective successors in office,
Appellees.

SYLLABUS BY THE COURT

1.

K.S.A. 66-118d limits judicial review of an order of the Kansas Corporation Commission (KCC) to determine whether the order is lawful or reasonable. A court has no power to set aside such an order unless it finds that the KCC acted unlawfully or unreasonably. An order is lawful if it is within the statutory authority of the commission and if the prescribed statutory and procedural rules are followed in making the order. An order is generally considered reasonable if it is based on substantial competent evidence. The legislature has vested the commission with wide discretion, and its findings have a presumption of validity on review. Discretionary authority has been delegated to the commission, not to the courts; the power of review does not give the courts authority to substitute their judgment for that

of the commission. The commission is aided by a staff of assistants with experience as statisticians, accountants and engineers, while courts have no comparable facilities for making the necessary determinations.

2.

The KCC is vested with the responsibility to prevent waste and to protect correlative rights of producers and landowners when production is from a common source of supply.

3.

The KCC's authority is limited to that conferred by statute.

4.

An order of the KCC will be set aside as arbitrary, capricious and unreasonable if it is not based upon substantial competent evidence.

5.

Where a regulatory body has authority to change positions on an issue if the new position is supported by substantial competent evidence, parties may not reasonably rely on any prior order of the body to such an extent to invoke the doctrine of equitable estoppel.

6.

It is within the discretionary authority of the commission to accept or reject any expert testimony presented. The facts to be considered and the weight to be accorded them are matters left to KCC discretion.

7.

Selling gas is not a function of the KCC, nor is the providing of incentives for additional production, but when additional production is needed to protect correlative rights and to prevent waste, the commission has authority to create such incentives.

8.

Federal regulation does not apply to production or gathering of natural gas. Thus, State control over allowables, which pertain to production, does not improperly infringe on federal regulation of natural gas in interstate commerce.

9.

Appeals under K.S.A. 55-606 go directly to the state Supreme Court, despite the provisions of K.S.A 1984 Supp. 60-2101.

10.

The right to an appeal is neither vested nor a constitutional right, but is strictly statutory in nature.

Appeal from Gray district court, DON C. SMITH, judge. Opinion filed May 10, 1985. Affirmed.

Mark H. Adams, II, of Adams, Jones, Robinson & Malone, of Wichita, argued the cause, and *Teresa J. James,* of the same firm, and *Bill Sears* and *John H. Cary,* of Tulsa, Oklahoma, were with him on the briefs for appellant Northwest Central Pipeline Corporation.

Ralph R. Brock, of Morris, Laing, Evans, Brock & Kennedy, Chartered, of Wichita, argued the cause, and *Robert W. Coykendall,* of the same firm, was with him on the brief for appellants Cabot Petroleum Corporation, Northern Pump Company, Graham-Michaelis Corporation, and Kansas Petroleum, Inc.

Timothy E. McKee, of Martin, Pringle, Oliver, Triplett & Wallace, of Wichita, argued the cause, and *William M. Lange* and *Kim R. Cocklin*, of Colorado Springs, Colorado, and *Robert A. Miller, Jr.*, of Lakewood, Colorado, were with him on the brief for appellants Colorado Interstate Gas Company and KN Energy, Inc.

Glenn D. Young, Jr., of Gott, Young & Bogle, P.A., of Wichita, argued the cause, and *Victor S. Nelson,* of

the same firm, was with him on the brief for appellant Amoco Production Company.

Charles H. Apt III, of Glaves, Weil, Evans & Hoke, of Wichita, argued the cause, and *Jack Glaves,* of the same firm, and *William Robertson,* of Kansas City, Missouri, were with him on the brief for appellee Panhandle Eastern Pipe Line Company.

Jeff Kennedy, assistant general counsel, argued the cause, and *Brian J. Moline,* general counsel, was with him on the brief for appellee Kansas Corporation Commission.

Richard C. Byrd, of Anderson, Byrd & Richeson, of Ottawa, argued the cause, and *Steven C. James,* of Amarillo, Texas, was with him on the brief for intervenor-appellee Mesa Petroleum Company.

The opinion of the court was delivered by

HERD, J.: This is an appeal from an order affirming a Kansas Corporation Commission (KCC) order amending paragraph (p) of the basic proration order of the Kansas Hugoton Gas Field.

Cabot Petroleum Corporation, Northern Pump Company, Graham-Michaelis Corporation, and Kansas Petroleum Inc., are independent producers of natural gas from the Kansas Hugoton Field and operate a total of 189 wells connected to various pipeline systems in the field. Colorado Interstate Gas Company and KN Energy, Inc. (KN) are interstate pipeline companies engaged in the transportation and sale for resale of natural gas in interstate commerce. KN is also engaged in the production of natural gas from the Hugoton Field and operates numerous wells which produce gas from that field. Northwest Central Pipeline Corporation (successor to Cities Service) is a pipeline company also operating in the Hugoton Field. Amoco Production

Company is also a lessee-producer of natural gas in the Hugoton Field. Each of these companies appeared before the KCC to contest the amendment to the basic order, and are appellants here. Panhandle Eastern Pipe Line Co. is an interstate pipeline which purchases gas from Hugoton wells. Panhandle participated in the hearings before the KCC and supported the KCC's position. Panhandle intervened in the appeal before the district court. Mesa Petroleum Company is a producer in the Hugoton Field. Mesa was a party to the proceedings before the KCC and supports the amended order.

The Kansas Hugoton Field is approximately one hundred sixty miles long and forty to seventy-two miles wide. It covers all or major portions of nine Kansas counties and minor portions of two additional counties. The over 4,000 gas wells in the field are connected to pipeline systems of seven major producers and several smaller purchasers.

The basic proration order for the Hugoton Field was adopted on March 21, 1944. The purpose of the order is to prorate the demand for gas, as determined twice a year by the commission, among all the wells in the Hugoton Field. The proration is made by assigning an allowable to each well. From its inception the basic proration order has assigned the allowables on the basis of the relative abilities of the wells to produce gas pursuant to a deliverability formula. The formula balances various factors in an effort to regulate production so that the amount produced over time from any well is equal to the amount of gas originally in the developed lease.

Some adjustments in allowables resulting from the deliverability formula are caused by pressure differentials in the various gas wells. Gas flows from high pressure areas to low pressure areas. A well's pressure

falls when it is produced. When a well is underproduced in relation to its allowable, and relative to the other wells which are producing their allowables, its pressure becomes higher. If this condition is permitted to continue over a period of time, drainage occurs from the underproduced well with the higher pressure to the low pressure area of the overproduced wells. As pressure is a major component in determining adjusted deliverability, the pressure differences result in a higher adjusted deliverability for the underproduced wells with a resulting increase in the current allowable. When the larger allowable and underage is produced, the well's pressure drops below the other wells and compensating drainage occurs. After the pressure drop the adjusted deliverability for the well is decreased with a resulting decrease in its allowable. This is the technique utilized in the attempt to keep the wells in balance in the long pull.

Divergent rates of "takes," as a result of varying market conditions experienced by the purchasers in the field, cause unplanned pressure differences among the producing wells. Every purchaser, because of varying market demands, has gone through cyclical periods of overproduction followed by periods of underproduction causing underages. The different purchasers are not in the same phase of the cycle at the same time. As a result, drainage among the developed leases is constantly taking place. Prior commission practice developed a system designed to ensure that counter or compensating drainage would occur.

The history of the field shows the turnaround in the marketing conditions of the various purchasers from periods of low demand to periods of high demand often takes many years. For example, Amoco's wells, 97% of which are connected to Northwest Central Pipeline, were underproduced in the late 1960's and early 1970's and

suffered great volumes of cancelled underage. From May, 1972, through 1981, 66,707,113 million cubic feet (MCF) of cancelled underage were reinstated, of which 60,650,544 MCF were produced. Now, however, due to high allowables assigned by the commission and soft market demand, these wells have suffered approximately 73.7 billion cubic feet (BCF) of cancelled underage and the volumes of cancellation are increasing monthly. Cabot, whose wells are also connected to Northwest Central, experienced this same cycle. Cabot suffered essentially no cancelled underage prior to 1967, but during the next six-years had 1,390,905 MCF cancelled, followed by a six-year period in which 1,158,808 MCF were reinstated, of which approximately 87% was produced. During the last three-and-a-half years Cabot again has suffered large volumes of cancelled underage. KN Energy was overproduced in the late 1960's and early 1970's, but became underproduced from approximately 1971 through 1977. It has been making up underage since 1978. It predicts it will take nine years to make up all of its underage. The Mesa wells, which are now 2.6 BCF overproduced, were underproduced in 1953 and incurred cancellations of underage with no reinstatement until 1964.

As of September 1, 1982, the entire Kansas Hugoton Field had an underage of 204.5 BCF as compared to 144.5 BCF underage September 1, 1981. According to KCC records, there have been 508 BCF of underages cancelled in the Kansas Hugoton Field from January 1, 1967 to August 1, 1982. 194 BCF of those underages were reinstated. It is significant to note that all appellants here are in an underproduced status currently, while Mesa and Panhandle are both in an overproduced status. History indicates market changes sufficient to make up underages have taken six to ten years.

Since it was first issued, various provisions of the basic order, including paragraph (p), have been amended, whenever the KCC determined any such provision was not adequately achieving the purpose of the order.

Because of the volume of underproduction, in March, 1982, the KCC began a general investigation into the provisions of the basic proration order to determine whether there was a need for revision. Hearings were held where it was determined some producers had accumulated excessively high underage in the Hugoton Field. As a result of the hearings, the commission issued its order on February 16, 1983, which amended paragraph (p) of the basic order for the avowed purpose of reducing underages.

Prior to this amendment to paragraph (p), the order permitted any well with an adjusted deliverability in excess of 300 MCF to accumulate underproduction equal to six times the amount of the current allowable assigned to the well for the preceding January. Any amount in excess of this formula was cancelled. The cancelled underage would then be reinstated if the producer could show the well was in an overproduced status and that purchasers were willing and able to take the gas within a reasonable time.

The amendments to paragraph (p) in dispute here divide the cancelled underage in the field into three categories: (1) underage cancelled prior to January 1, 1975; (2) underage cancelled between January 1, 1975, and December 31, 1982; and (3) underage cancelled after December 31, 1982. For each of these categories of underage the commission established requirements to be met by producers seeking to have such underage reinstated. For the pre-1975 cancelled underage, a producer was required to make application for reinstatement with the commission on or before December 31,

1983. For 1975 to 1982 cancelled underage, reinstatement must be requested by December 31, 1985. For underage cancelled after December 31, 1982, the producer has three years from the date of cancellation to apply for reinstatement. For any producer to request reinstatement of underage cancelled after 1974, the affected well must be in an overproduced status. Any underage not reinstated, or if reinstated not produced at the end of the allotted time period, will be cancelled permanently. A producer has sixty months in which to produce the reinstated underage.

After rehearing by the KCC in which the commission's order was affirmed, the case was appealed to the district court. The district court affirmed the commission's order.

Prior to separate discussion of the issues it is important to remember the scope of appellate review of KCC orders. We recently set out the rules in *Oilfield Fluid Motor Carriers v. Kansas Corporation Comm'n.*, 234 Kan. 983, 677 P.2d 982 (1984), where we stated:

> " 'K.S.A. 1978 Supp. 66-118d limits judicial review of an order by the commission to determining whether the order is "lawful" or "reasonable." *Kansas Gas & Electric Co. v. State Corporation Commission*, 218 Kan. 670, Syl. ¶1, 544 P.2d 1396 (1976). A court has no power to set aside such an order unles it finds that the commission acted unlawfully or unreasonably. *Jones v. Kansas Gas and Electric Co.*, 222 Kan. 390, 396-7, 565 P.2d 597 (1977). An order is "lawful" if it is within the statutory authority of the commission, and if the prescribed statutory and procedural rules are followed in making the order. *Central Kansas Power Co. v. State Corporation Commission*, 221 Kan. 505, Syl. ¶1, 561 P.2d 779 (1977). An order is generally considered

"reasonable" if it is based on substantial competent evidence. *Jones v. Kansas Gas and Electric Co.*, 222 Kan. 390, Syl. ¶2.

" 'The legislature has vested the commission with wide discretion and its findings have a presumption of validity on review. *Central Kansas Power Co. v. State Corporation Commission*, 221 Kan. at 511. Since discretionary authority has been delegated to the commission, not to the courts, the power of review does not give the courts authority to substitute their judgment for that of the commission. *Central Kansas Power Co. v. State Corporation Commission*, 206 Kan. 670, 675, 482 P.2d 1 (1971). The commission's decisions involve the difficult problems of policy, accounting, economics and other special knowledge that go into fixing utility rates. It is aided by a staff of assistants with experience as statisticians, accountants and engineers, while courts have no comparable facilities for making the necessary determinations. *Southwestern Bell Tel. Co. v. State Corporation Commission*, 192 Kan. 39, 48-9, 386 P.2d 515 (1963).' " 234 Kan. at 986, quoting *Midwest Gas Users Ass'n. v. Kansas Corporation Commission*, 3 Kan. App. 2d 376, 595 P.2d 735, *rev denied* 226 Kan. 792 (1979).

The first issue raised in this appeal is whether the order of the KCC is in violation of K.S.A. 55-703.

The KCC is vested with the responsibility to protect correlative rights of producers and landowners when production is from a common source of supply. K.S.A 55-703 provides that whenever the available production of natural gas exceeds the market demand, then,

"any person, firm or corporation having the right to produce natural gas from the common source of supply may produce only that portion of all the

> natural gas that may be currently produced without waste and to satisfy the market demands, as will permit each developed lease to ultimately produce approximately the amount of gas underlying the developed lease and currently produce proportionately with other developed leases in the common source of supply without uncompensated cognizable drainage between separately-owned, developed leases or parts thereof.
>
> "The commission shall regulate the taking of natural gas from any and all common sources of supply within this state in order to prevent the inequitable or unfair taking of natural gas from a common source of supply . . . ."

Thus, the KCC's duty under K.S.A. 55-703 is to prevent waste and protect correlative rights. Appellants argue that in order to issue its current order, the KCC redefined correlative rights. "Correlative rights" has been defined by the KCC in the past as follows:

> " 'Correlative rights' means that each owner or producer in a common source of supply is privileged to produce from that supply only in a manner or amount that will not injure the reservoir to the detriment of others, take an undue proportion of the obtainable oil or gas, or cause undue drainage between developed leases." K.A.R. 82-3-101(15).

The KCC argues it has not redefined "correlative rights," but that in addition to the definition contained in K.A.R. 82-3-101(15), the KCC must also apply the statutory provisions which further define correlative rights as those which only exist "currently." For support the KCC cites K.S.A 55-703, which states individuals have the right to produce gas from the common source of supply "that may be *currently* produced" and they may "*currently* produce proportionately with

other developed leases in the common source of supply." Appellants argue the KCC's position that it may define correlative rights as that which can be *currently* produced, effectively eliminates their right to regain, through long-term recovery of underages, their fair share of the gas in the Hugoton area.

Appellants also argue that the KCC's reliance on the language in K.S.A. 55-703, which includes the word "currently," misconstrues the statue, since it fails to take into consideration the qualifying phrase which follows in the statute. That phrase is "without uncompensated cognizable drainage between separately-owned, developed leases or parts thereof." Thus, the word "currently" allegedly is not allowed to be singled out when there are significant drainage problems. For support appellants cite *Cities Service Oil Co. v. State Corporation Commission*, 205 Kan. 655, 668-69, 472 P.2d 257 (1970), where it was held:

> "As indicated, drainage is inevitable in an active field such as the Hugoton. The deliverability formula contemplates counter drainage and thus provides compensated drainage in a subsequent period of time, recognizing the impossibility of applying the literal meaning of the word currently."

Appellants also cite the language of K.S.A. 55-703 which states correlative rights are to be determined according to what each lease will "ultimately produce." Appellants argue that if their underages are permanently cancelled here they will not be able to receive counter drainage and thus *ultimately* they will not receive a proper share of the common source of supply.

In support of its order, the KCC cites *Republic Natural Gas Co. v. State Corporation Commission*, 173 Kan. 172, 244 P.2d 1196 (1952), which discusses the application of the term "currently" in 55-703. In that case

an order of the KCC denying reinstatement of a cancelled underage was appealed. The appellants in that case argued if their underage in the Hugoton Field was permanently cancelled, their correlative rights would be violated. In affirming the KCC we stated: "This argument fails to take into consideration the time element in proration." 172 Kan. at 179. The court noted paragraph (p) was placed in the basic order by the KCC because of the difficulty involved in causing a well to produce exactly its allowable each month. Based upon this rationale, the court held the correlative rights which the KCC must protect pursuant to 55-703 include the portion of all the natural gas that may be *currently* produced, without waste and to satisfy the market demands. 173 Kan. at 180.

Appellants here argue *Republic* is clearly distinguishable from the instant case. In *Republic*, the KCC was engaged in *limiting* production in order to protect correlative rights. Here, appellants allege the commission inappropriately utilizes the language of *Republic* to support its attempts to *induce* greater production by giving the market incentives and thus create greater demand.

Appellants also argue the KCC has unlawfully delegated to the purchasers its authority to protect the correlative rights. The reasoning here is since gas cannot be stored but can only be produced when there is a purchaser, under the amendment to paragraph (p) it is up to the purchasers to take enough gas from the producers with significant underages to prevent the cancellation of those underages.

After careful consideration, we are led to the conclusion the KCC's new definition of correlative rights is incorrect. It ignores both K.S.A. 55-703 and K.A.R. 82-3-101(15). There the emphasis is on preventing the

inequitable and unjust taking of natural gas from a common source of supply with the objective of providing a way for each developed lease to ultimately produce the gas underlying it. The statutory reference to "currently produce" must be interpreted with the rest of the sentence. It is then apparent the legislature ordered current production to be proportionate with other leases in the pool, without drainage, to attain equity.

That, however, does not resolve this issue. The KCC order amending paragaph (p) of its basic Hugoton Field proration order does not necessarily conform to its own new definition of correlative rights with the emphasis on current production. The amended order provides each producer an opportunity to reinstate its cancelled underages and thus the right to ultimately recover the gas under its leases. As argued by the KCC, such an opportunity is all the KCC can provide as it is impossible to force current equal production from all wells in the common source of supply.

Some of the appellants also argue that the problem was caused by the KCC because it ignored the current market demand and set the allowables too high. Allowables have been set many times above the market demand. While this is true, the allowables were not appealed and are thus not at issue in this case. The issue is whether the order violates the provisions of K.S.A. 55-703.

Appellants next contend there is substantial evidence the KCC acted beyond its authority as established in K.S.A. 55-703, when it failed to prevent waste and ensure equitable taking but instead amended paragraph (p) to increase production in the Hugoton Field. We have held the KCC's authority is limited to that conferred by statute. *Bennett v. Corporation Commission*, 157 Kan. 589, 596, 142 P.2d 810 (1943).

The testimony of Ron Cook, the sole KCC witness, supported by Michael S. Daugherty, Mesa's witness, Jimmy Mogg of Panhandle and Robert M. Danos of KN Energy, provides the evidence the KCC relied upon in making its amendment. See *Colorado Interstate Gas Co. v. State Corporation Commission*, 192 Kan. 1 Syl. ¶6, 386 P.2d 266 (1963), *cert denied* 379 U.S. 131 (1964). Cook testified the purpose of the amendment was to increase production. The order of February 16, 1983, also states the purpose of the order is to increase production. Appellants argue this purpose is beyond the KCC's authority. For support, appellants note there are no statutes which give the KCC authority to encourage production. Appellants also cite *Rush v. King Oil Co.*, 220 Kan. 616, 556 P.2d 431 (1976), to uphold their position. In *Rush*, the trial court ordered the drilling and development of a particular oil and gas lease. The trial court held the development was required in order for the lessee to comply with the implied covenants of reasonable development and protection against drainage. This court held the trial court's order was not invalidated by the KCC proration order establishing allowables for production, stating that the purpose of K.S.A. 55-601 *et seq*, "is not to give the corporation commission the power to regulate development but rather to prevent waste and the unfair or inequitable taking of oil from any pool." 220 Kan. at 627. Appellants urge that the power to regulate development is similar to the power to encourage production, and is thus not allowed under Kansas law pursuant to *Rush*.

Appellants also cite *Thompson v. Consolidated Gas Co.*, 300 U.S. 55, 81 L.Ed. 510, 57 S.Ct. 364 (1937), for authority that the encouragement of production is beyond the authority of the KCC. In *Thompson*, the authority of the Texas Railroad Commission was questioned under a Texas statute which allowed the commis-

sion the power to regulate natural gas activity in the state for the purpose of preventing waste and protecting correlative rights. The commission had issued an order establishing allowables in certain fields at very low levels in an attempt to encourage producers to take gas from other fields, not subject to the order, which were substantially underproduced. The order was challenged arguing it was coercive and its purpose and effect was not to prevent waste or protect correlative rights but to "compel" pipelines to take gas for which no market existed. The United States Supreme Court held the order was inconsistent with the purposes of the Texas gas conservation statute and the proration orders setting the low allowables were invalid as they bore no reasonable relation to the purposes of the statute. The court found there was no waste evident in the gas fields which were under the subject orders. Appellants here thereby conclude that since the purpose of the amendment is specifically to increase and encourage production in the Hugoton Field and not to prevent waste or to protect correlative rights, the order is beyond the KCC's authority and is thereby void.

Appelless argue it is within the KCC's authority to determine when field conditions and demand for natural gas necessitate a change in the basic order. Appellees cite *Colorado Interstate Gas Co. v. State Corporation Commission*, 192 Kan. at 25, for authority that:

> "When waste, market demand, and correlative rights are in conflict the Commission must determine which is to be given preference. If the decision of the Commission is supported by evidence, the courts cannot interfere."

Appellees therefore argue it is completely within the commission's discretion to cancel the underages when it is determined the underages have affected market de-

mand. Furthermore, the appelless argue the commission is only required to

> "afford each other the 'right or opportunity' to produce his share. As far as the Commission's duty under the basic order goes, it is fulfilled when each owner is legally 'free to produce' and not denied the 'right or opportunity' to produce his allowable." 192 Kan. at 25.

Hence, appellees argue the KCC has provided the opportunity to produce, which is within its authority.

Appellants next argue the order of the KCC is arbitrary and capricious. It is well established in Kansas that an order of the state corporation commission will be set aside as arbitrary, capricious or unreasonable if it is not based upon substantial competent evidence. *Southern Kansas Stage Lines Co. v Public Service Comm.*, 135 Kan. 657, 11 P.2d 985 (1932); *Colorado Interstate Gas Co. v. State Corporation Commission*, 192 Kan. at 14-15.

Appellants argue initially that the arbitrariness of the commission's disputed order can be determined from the fact that it is a change from its prior stand on the issue. For many years the commission followed a policy of ordering the reinstatement of cancelled underages when requested to do so if the purchaser was willing and able to take the gas. The orders reinstating cancelled underage were done "in protection of correlative rights and to permit said wells to produce their fair share of gas from under the field." The commission's current order, however, states that to protect correlative rights it must now *permanently* cancel underages which cannot be produced within the given time. This represents a change in the KCC's position. That, however, does not prove the KCC action was arbitrary, capricious or unreasonable. A regulatory body has authority to change

positions on an issue if the new position is supported by substantial, competent evidence. *Warburton v. Warkentin*, 85 Kan. 468, 476-77, 345 P.2d 992 (1959). Here there was evidence the Hugoton Field required additional production to protect correlative rights. Commission action was thus prompted.

Appellants next argue even if the KCC has authority to promote production, the KCC has no idea whether its order will have that effect, and hence the action is arbitrary. For support, appellants cite the testimony of the KCC's witness, Cook, who testified at the hearing that he only hoped his plan would be an incentive to production. Since the actual production will be dependent upon whether pruchasers decide to purchase this new abundant amount of gas from the Hugoton Field and there is no way the KCC can compel the purchase, there is no way to know if the KCC's order will actually produce the effect it desires. Additionally, appellants argue the order will not have the KCC' desired effect of increasing production because purchasers will have to choose between taking under their take or pay contracts or taking from the Hugoton producers. Since it would be quite costly to take from Hugoton and make the payments required under the other contracts, appellants argue the pipelines will not increase their Hugoton takes. Hence, appellants argue the order is unreasonable.

Appellants finally argue that the order is arbitrary and capricious because it promotes waste and permanently affects the correlative rights of the parties. For support, appellants argue that many experts testified at trial that if the order is followed which requires production within this short amount of time the increased production with the change in pressure will result in water production by the gas wells. This move-

ment of water into the gas field will also result in waste in that it will cut off gas in some parts of the field, thereby causing substantial waste. Appellants also point to the drainage and counter drainage over the history of the field. If the underages are permanently cancelled those that have experienced underages will never be able to regain their full share of the gas since the amount they were allowed to take has been cut off by the KCC's order.

Panhandle Eastern argues the KCC's order is not arbitrary, citing *Republic Natural Gas Co. v. State Corporation Commission*, 173 Kan. 172, wherein we stated:

> "There is nothing hard and fast, unreasonable or arbitrary about the cancellation of accumulated underages. . . .
>
> "The entire matter, not of the cancellation, but of what effect the cancellation will have on future production of any well is a matter addressed to the judgment and discretion of the commission after a hearing." 173 Kan. at 181.

Appellants argue *Republic* is distinguishable from the instant case since it simply holds that cancellation will not result in violation of correlative rights so long as *actual* production is being spread among the wells in the field. Appellants contend this is not what the commission has been doing here. They contend instead of prorating actual production among the wells in the field, the KCC has allegedly been spreading fictional market demands, which are far in excess of the ability of many of the interstate markets to absorb.

The KCC responds that many of the experts at the hearing testified that the Hugoton Field is not presently in balance and that correlative rights have been and are currently being violated due to the severe underage problem. Appellants argue, however, the KCC's order

will not correct the problem. While the method of correcting a problem is generally within the KCC's sole discretion, unless it is arbitrary, capricious and ignores the evidence, then this court must hold the order improper.

Appellees contend it is within the discretionary authority of the commission to accept or reject any expert testimony presented. *Union Gas System, Inc. v. Kansas Corporation Commission*, 8 Kan. App. 2d 583, Syl. ¶1, 663 P.2d 304 *rev denied* 233 Kan. 1093 (1983). The facts to be considered and the weight to be accorded them are matters left to KCC discretion. See *Colorado Interstate Gas Co. v. State Corporation Comm.*, 192 Kan. 1, Syl. ¶6. The question, therefore, finally narrows to whether there was substantial competent evidence to support the KCC's order in this case.

The KCC through its expert, Ron Cook, whose testimony was corroborated by Michael S. Daugherty and Robert M. Danos, introduced evidence that the accumulation of underages in the Hugoton Field had rendered the field so out of balance it was seriously impairing the correlative rights of the landowners and operators. Cook testified:

> "Correlative rights have been and are currently being violated by the uncompensated drainage that is occurring due to the unratable taking of allowables between offsetting leases. Future projections of gas production from the Hugoton Field indicate that this trend of accumulating more underage and cancelled underage will continue for a number of years.
>
> "There is a definite possibility that near the end of many of the wells' productive lives, there will be a tremendous amount of cancelled underage that will never be reinstated due to the physical inabili-

ty of the wells to make up such underage. This will result in a greater violation of correlative rights, because under the present provisions of Paragraph P of the basic order, there is no incentive to reinstate cancelled underage in a timely manner. . . ."

Cook's analysis and conclusions were seriously challenged by Lester Wilkonson, a petroleum engineer, whose testimony was adopted by all of the appellants. Mr. Wilkonson maintains the amendment to paragraph (p) will have the opposite effect to that desired by the commission. He agrees that more production is needed from the Hugoton Field but asserts it will not be obtained by the method chosen by the KCC. He further asserts that correlative rights of the owners and operators will be permanently damaged by the proposed cancellation of underages. He claims the schedule proposed for reinstating underages is tantamount to complete cancellation of them because with the weak market demand the pipelines cannot take enough additional gas from the producers to place them in an overage state. With regard to cancellation of underages, he testified:

"We have gone through periods when moratoriums were in effect and no underage was cancelled. Too, the flexibility limits of cancelling underproduction and overproduction have also been changed from time to time. As long as underage could be reinstated, no one had serious objection to the cancellation provisions. However, I personally have felt that cancellation of a portion of underage actually removed the 'heat' from the purchasers to take gas. In other words, if the public record reflects only a portion of the underage, the purchaser's takes do not appear to be too far out of line. In my opinion, if any change is to be made in the cancellation provisions of paragraph "p," it should be to

place all underage, both present and cancelled, back on the report so we may take our heads out of the sand and see the true status of the individual wells connected to the various purchasers."

Michael S. Daugherty, a petroleum engineer for Mesa, had a different point of view:

"Mesa is aware of the recent reduction in the demand for natural gas industry-wide. It is our opinion that this reduced demand is due both to conservation efforts of the consumers, largely brought about by the increase in price, and the present business recession in the national economy. We are aware of the reduced markets of the interstate purchasers. However, the evidence presented by the purchasers and the Commission staff in the recent Market Demand hearings indicates that the Hugoton Field has suffered a proportionately greater reduction in the takes than the other fields from which the purchasers are buying gas. In Mesa's opinion this is not fair to the Hugoton producers, the royalty owners, the taxing entities within the state or to Kansas consumers."

He went on to say that purchasers have reduced their Hugoton Field purchases

"due to the existence of take or pay contract provisions in the purchasers' contracts in other fields and the more restrictive tolerance provisions in the basic proration orders of the other fields. In my opinion, this makes it easier to use Hugoton for storage than the other fields from which the purchasers buy gas."

In response to a question about the benefits of Hugoton gas to Kansas consumers, Mr Daugherty stated:

"[G]enerally speaking, the Hugoton Field gas is the

cheapest gas available to the purchasers. Any reduction in the cost of gas due to increased runs from Hugoton is flowed through to the Kansas consumer."

Daugherty continued:

"Mesa's intrastate purchaser, Kansas Power and Light Company, forecasts that approximately 37% (14 BCF of 38 BCF) of its main system gas for the winter period in 1982-83 will be obtained from Mesa out of the Hugoton and Council Grove Fields. This 14 BCF of gas is presently priced at approximately 67¢ per MCF. Low takes by other purchasers from the field and the resulting reduction in market demand from the Hugoton Field have necessitated KPL to seek additional short term supplies of gas. They have entered into a five (5) year contract with Cities Service Gas for approximately 8 BCF of gas per year. The November 1982 price of this gas will be in excess of $4.00 per MCF. The difference between the price of this gas and Hugoton 67¢/MCF gas from Mesa will be passed on to their Kansas customers."

In response to questions, Daugherty then testified:

Q: What will KPL's cost be for this gas?

A: It appears that over the next five years KPL will purchase up to about 40 Bcf at over $4.00/Mcf at a total cost of about $160 million.

Q: How much would that amount of gas cost KPL if it were purchased from Mesa at 67¢/Mcf?

A: About $27 million.

Q: Will any of the gas sold to KPL by Cities Service Gas come from the Kansas Hugoton Field?

A: It is possible that some of it could come from

the Kansas Hugoton Field, and to the extent that it does it will help to increase Cities Service's runs from the field. However, it should be pointed out that the producers and royalty owners will not share in the $4.00-plus price that KPL and its customers pay for this gas. Cities will be paying the producer an average of approximately 50¢/Mcf, the present NGPA Section 104 price, for whatever portion of the 8 Bcf of gas that is produced from Hugoton. The royalty owners and Kansas taxes are paid based on the 59¢/Mcf gas price. If the market demand, allowables and production in the field were at the level they have been in the past, 500 to 550 Bcf per year, KPL's customers could be receiving their requirements from Mesa at a much lower cost. To my knowledge, there is no gas being produced and sold by producers from the Hugoton Field that even approaches the $4.00-plus price that KPL is to pay Cities Service."

The testimony shows the KCC had evidence from experts who held different point of view. KCC chose to believe Cook and Daugherty. That is the KCC's prerogative. In *Colorado Interstate Gas Co. v. State Corporation Commission*, 192 Kan. 1, we stated:

"In considering the validity of the Commission's determination, the courts can consider only the statutes granting the Commission's authority and the Commission's basic order with such amendments as are properly made thereto. The determination is a question of fact. What facts are to be considered and the relative weight to be accorded them are matters left to the Commission's discretion. Unless the determination is arbitrarily or capriciously made without supporting evidence, the courts cannot interfere and substitute their judg-

ment for that of the Commission. The question for the reviewing court is the power of the Commission to make the order, not its wisdom, propriety or expediency in having made it." 192 Kan. at 18.

The weight and logic of the evidence raises serious questions of the producers' ability to persuade the purchasers to take enough additional gas to acquire an overproduced state in time to avoid permanent cancellation of underages. However, there is substantial competent evidence in the record indicating otherwise under ideal circumstances. Thus, our doubts about the soundness of the KCC decision are not grounds for reversal. It is a matter of judgment and we are not permitted to substitute our judgment for that of the commission.

The KCC's dilemma is apparent. It was concerned about the dramatic decline in production from Hugoton and its effect on owners, producers and consumers. It sought ways to increase Hugoton production. It increased allowables in spite of reduced purchaser nominations and other evidence of less market demand. As a result, the disparity between overproducers and underproducers increased. It is arguable whether reduced production from the field was caused by a conscious choice of producers and pruchasers to supply their demands from other sources and make Hugoton Field a storage facility or whether it was simply caused by reduced market demand. The KCC believed the former and amended paragraph (p) of the basic order to provide an incentive for production by permanently cancelling underages if not recovered on an accelerated schedule. Even though the testimony of Mr. Wilkonson was quite persuasive that the amendment would not have the desired effect of increasing production, but would instead result in a cancellation of all underages, we find there was substantial competent evidence to

support the KCC's conclusion that correlative rights were being compromised by the excessive underages. This is the threshold issue which must be met before the KCC is authorized to make such orders as are necessary to correct the problem. While selling gas is not a function of the KCC, except tangentially through setting allowables, nor is the providing of incentives for additional production a KCC function, when additional production is needed to protect correlative rights, the KCC has authority to create such incentives. K.S.A. 55-703 provides:

> "The commission shall regulate the taking of natural gas from any and all common sources of supply within this state in order to prevent the inequitable or unfair taking of natural gas from a common source of supply by any person, firm or corporation and to prevent unreasonable discrimination in favor of any one common source of supply as against another and in favor of or against any producer in any common source of supply."

We conclude the KCC acted lawfully and reasonably in this case.

Appellants next argue the KCC order improperly interferes with federal regulation of natural gas in interstate commerce.

In *Northern Gas Co. v. Comm'n.*, 372 U.S. 84, 9 L.Ed.2d 601, 83 S.Ct. 646 (1963), the United States Supreme Court struck down an order of the commission requiring Northern Natural Gas and other purchasers in the Hugoton Field to take ratably from the wells to which they were connected. The court reminded the commission that Congress enacted a comprehensive scheme of federal regulation of all wholesales of natural gas in interstate commerce, which leaves no room for direct or indirect regulation by the states that affects or may af-

fect the ability of the federal power commission (now the Federal Energy Regulatory Commission [FERC]) to regulate completely and effectively the transportation and sale of natural gas in interstate commerce. The commission's ratable take order was invalidated under the following holding:

> "Moreover, any readjustment of purchasing patterns which such orders might require of purchasers who previously took unratably could seriously impair the Federal Commission's authority to regulate the intricate relationship between the purchasers' cost structures and eventual cost to wholesale customers who sell to consumers in other States. This relationship is a matter with respect to which Congress has given the Federal Power Commission paramount and exclusive authority." 372 U.S. at 92.

Appellants argue, and the trial court agreed, that the effect of the KCC's order, if the purchasers decided to divert purchasers from other fields to prevent the cancellation of their underages in Hugoton, would decrease production from other fields in other states. The district court specifically found the order would induce increased production from the Hugoton Field and found that "[a]s a practical matter, the change in 'p' will . . . cause a change in the 'mix' of natural gas which pipelines transport for sale many miles away."

The district court found, however, that since the KCC order deals with producers of natural gas, rather than specifically ordering the purchasers to do anything, it falls within the specific exemption of the Natural Gas Act. This is consistent with the KCC's position that the obligations imposed by the order are on the producers, who are exempt from the Federal act, not the purchasers.

Appellants argue the nature of gas automatically means the order controls the purchasers. Since gas may

not be produced unless there is a purchaser, the order affects purchasers equally with the producers. Appellants note the testimony of Mr. Cook, the KCC's witness, who testified the purpose of the order was to effect production in the Hugoton Field. Appellants further note *Northern Gas*, which discusses the infringement by the states in the area of natural gas production and purchase:

> "The Natural Gas Act precludes not merely *direct* regulation by the States of such contractual matters. . . .
>
> "The federal regulatory scheme leaves no room either for direct state regulation of the prices of interstate wholesales of natural gas, [citation omitted] or for state regulations which would indirectly achieve the same result." 372 U.S. at 91.

Appellants also point out all that need be shown is an "imminent possibility of collision" between the KCC's order and the federal scheme of regulation. 372 U.S. at 92.

Appellees argue *Northern Gas* is distinguishable from the instant case. There the orders were "unmistakably and unambiguously directed at *purchasers* who take gas in Kansas for release after transportation in interstate commerce." 372 U.S. at 92. The United States Supreme Court noted that criminal sanctions for violations of the orders would fall, not upon the producers, but upon the pipeline purchaser. The order in the instate case gives us pause. It obviously is intended for purchasers, but is directed to producers. Hence, the question which this court must decide is whether this indirect effort to influence purchasers meets the standards noted in *Northern Gas*, which would preclude state regulation in this area. As stated in *Northern Gas*, federal regulation does not apply to the production or

gathering of natural gas. Interpreted in a narrow sense, as suggested by *Northern Gas*, the matter of allowables must be construed to pertain to production. The state has regulatory authority over production. The rules on underages are a part of production regulation and thus are not violative of the federal act, even though purchasers are indirectly caught in the backwash.

Appellants next argue the doctrine of equitable estoppel bars the enforcement of the KCC order amending paragraph (p). Appellants allege the KCC order has the effect of making it illegal to reinstate underage volumes which were previously allowed to accumulate legally. Appellants note the order does not operate prospectively by prohibiting the accumulation of future underage or reducing the extent of overproduction after which underage would be cancelled; rather, the order sets an "arbitrary" period of time for producers and purchasers to bring wells into an overproduced status, seek reinstatement of the cancelled underage, and produce the same. Appellants argue this is inconsistent with the doctrine of equitable estoppel. In *Bowen v. Westerhaus*, 224 Kan. 42, 46, 578 P.2d 1102 (1978), this court reviewed the law concerning equitable estoppel and held:

> "Equitable estoppel is the effect of the voluntary conduct of a person whereby he is precluded, both at law and in equity, from asserting rights against another person relying on such conduct. A party asserting equitable estoppel must show that another party, by its acts, representations, admissions, or silence when it had a duty to speak induced it to believe certain facts existed. It must also show it rightfully relied and acted upon such belief and would now be prejudiced if the other party were permitted to deny the existence of such facts."

Appellees argue in response that estoppel against

a government agency should not be invoked except in rare and unusual circumstances and may not be invoked where it would serve to defeat the effective operation of a policy adopted to protect the public. 31 C.J.S., Estoppel §138. Appellants argue the order of the KCC in dispute here is not a policy adopted to protect the public or even to fulfill the duties of the KCC; rather, it is merely to induce an increase in production.

Appellees note there is no vested right to produce gas in the Hugoton Field. Further, the KCC must be given, and has been given, discretion to amend the basic order in the public interest when the evidence indicates that conditions in the Hugoton Field warrant a change. See *Colorado Interstate Gas Co. v. State Corporation Comm.*, 192 Kan. 1, 28-29, 386 P.2d 266 (1963). Because authority has been granted to the KCC to modify the order when it deems necessary, appellants cannot reasonably relay on any prior orders of the KCC to such an extent as to invoke the doctrine of equitable estoppel. A regulatory body's orders are not a commitment and may be changed, reversed or amended in lawful and based on substantial competent evidence. This issue must fail.

Appellee Panhandle Eastern argues this appeal was improperly taken directly to the Supreme Court. Appellants, however, note this appeal was taken from the district court pursuant to K.S.A. 55-606. That statute provides that "[a]ppeals to the state supreme court may be taken from the judgment of the district court as in other civil actions." Panhandle Eastern argues civil actions may be taken directly to the state Supreme Court only "from a final judgment of a district court in any civil action in which a statute of this state or the United States has been held unconstitutional. . . ." K.S.A. 1984 Supp. 60-2101. Thus, appellee argues, since this case does not involve the constitutionality of a statute, this ap-

peal was improperly brought to the Supreme Court instead of the Court of Appeals.

There are several statutes still lingering on the books which provide for a direct appeal to the Supreme Court under circumstances other than those noted in K.S.A. 1984 Supp. 60-2101. Among these are K.S.A. 55-606. Professor Gard in his comment to K.S.A. 60-2101 states:

> "Note should be taken of any special statutes which provide for review of judicial or quasi judicial orders of certain administrative agencies by direct appeal to the supreme court. Such statutory provisions, until amended, should be considered as limitations on the court of appeals authority under this section." 2 Gard's Kan. C. Civ. Proc. 2d Annot. §60-2101, p. 89 (1979).

Hence, since this statute has not been amended the legislature has clearly intended appeals under K.S.A. 55-606 to go directly to the Supreme Court. This argument is without merit.

Intervenor Mesa Petroleum Co. argues the pipelines do not have standing in this case. Mesa reasons that the rights of the mineral owners are commonly referred to as correlative rights. Those who possess correlative rights are the mineral interest owners. The Kansas Supreme Court has defined "mineral interest" to be:

> "The term 'mineral interest' as commonly used refers to the oil and gas in place and constitutes a present ownership of an interest in real property. [Citation omitted.] A prime characteristic of a mineral interest is the right to enter the land to produce and carry on production activities. This right may be leased to others." *Stratmann v. Stratmann*, 204 Kan. 658, 662, 465 P.2d 938 (1970).

Since the pipeline purchasers have no mineral interest in the Hugoton Field, they have no correlative rights. Hence, Mesa argues they lack standing to appeal an order of the KCC relating solely to the prevention of waste and protection of correlative rights.

Appellants argue this issue was raised before the district court and denied. Appellees did not cross-appeal this issue, hence, the issue is not properly before this court. We have consistently held the right to an appeal is neither vested nor a constitutional right, but is strictly statutory in nature. See *In Re K-Mart Corp.*, 232 Kan. 387, Syl. ¶2, 654, P.2d 470 (1982). Thus, since a cross-appeal was not taken this court will not consider this issue.

The judgment of the trial court is affirmed.

SCHROEDER, C. J., dissenting: As applied to this case, the KCC's duty under K.S.A. 55-703 is to *prevent waste and protect correlative rights* in the production of natural gas from the Hugoton Field, located in Kansas. The KCC is obligated by legislative mandate, where regulation is required, as here, to permit production of gas from the common source of supply of "only that portion of all the natural gas that may be currently produced without waste and *to satisfy the market demands*, as will permit each developed lease to ultimately produce approximately the amount of gas underlying the developed lease and currently produce proportionately with other developed leases in the common source of supply without uncompensated cognizable drainage between separately-owned, developed leases or parts thereof." K.S.A. 55-703. (Emphasis added.)

The pipeline companies that purchase natural gas in Kansas and other states for transportation in interstate commerce for resale have a right to purchase gas

from their contracted dedicated reserves. Natural gas cannot be produced unless a purchaser is ready to buy it; it cannot be stored in a tank on the lease. *Northern Natural Gas Co. v. State Corporation Commission*, 188 Kan. 355, 360, 362 P.2d 599 (1961). *rev'd* 372 U.S. 84 (1963). Thus it is the purchasers who supply the market to the field, which according to the basic order is supposed to be prorated among the wells in the field.

In this case the KCC continuously fixed allowables for some time far in excess of requirements to supply the demand for natural gas which resulted in a huge underage of production in the Hugoton Field. This underage has been accruing since January 1, 1967. Since 1975 alone, the KCC has granted 275 BCF allowable in excess of actual production.

In my opinion, the KCC has exceeded its statutory authority in fixing allowables far in excess of demand. This is clearly indicated by the huge underage existing in the Hugoton Field. This in turn has had its impact on drainage in the field illustrated by the fact that Mesa has no underage, but is in a state of overproduction. The statutory obligation of KCC to protect correlative rights has, therefore, been ignored.

I would reverse and hold the KCC order amending the basic proration order by changing paragraph (p) to be invalid because it exceeds legislative authority. The fact that some expert may venture an opinion that this action is the solution to an existing problem in the field is wholly immaterial.

Even assuming arguendo that this infirmity is ignored, as the court in its opinion has done, the KCC has no jurisdiction to proceed on the theory it has adopted to amend the basic proration order. Federal preemption excercised through FERC's interstate regulatory authority nullifies the KCC order.

Many of the pipeline systems which transport natural gas from the Kansas Hugoton Field are integrated with pipeline systems connecting other gas fields, and natural gas from the Kansas field is thereby commingled with gas from other fields, including the Oklahoma and Texas portions of the Hugoton Gas Field. *Colorado Interstate Gas Co. v. State Corporation Comm.*, 192 Kan. 1, 5, 386 P.2d 266 (1963), *cert. denied* 379 U.S. 131 (1964). The connected reserves of the interstate purchasers in the field are a significant part of their total system-wide reserves. Any increase or decrease in the volumes of gas purchased within the state of Kansas changes the volumes of gas purchased outside the state (change in the "mix") and will change the average cost of gas to the purchasers. FERC's exclusive jurisdiction extends to the regulation of the intricate relationship between the purchasers' cost structures and the eventual cost to distributors who sell to consumers in other states. *Northern Gas Co. v. Kansas Comm'n,* 372 U.S. 84, 9 L.Ed.2d 601, 83 S.Ct. 646 (1963).

Although the commission contends that its order is directed at producers not purchasers, its real purpose is to create an impact on purchasers' business decisions concerning the makeup of their interstate gas mix, with an eye toward making it economically prohibitive for such purchasers not to purchase increased substantial volumes of gas from the Kansas Hugoton Field even at the expense of their purchases from other states. The commission has not been correlating allowables with demand, ever seeking to compel purchasers to purchase more Kansas gas. Faced with mounting underages, increasing the imbalance in the field, the commission now attempts to use its ultimate weapon, the power to cancel forever the right to purchase connected reserves of a

pipeline, insofar as it fails to purchase those volumes within the arbitrary period allotted by the commission.

This is clear from the commission's own findings. It found in the order that the correlative rights of a producer is the right to participate in a given market for a given period of time. (This does not compare with the definition of correlative rights in the commission's own Rule 82-3-101[15]). It found that the problem with correlative rights violation *does not result from the assignment of the allowables*, but rather from the failure of producers and pipelines to take production from the field. It found that its previous flexible reinstatement provision induced a lack of incentive to produce resulting in depriving some operators of the opportunity to participate in a given market, and that this resulted in discrimination. "It is the purpose of this Order not to restrict production of gas but to encourage it." Its interest was to provide sufficient incentive to "produce allowables," to encourage "production of current allowables," and create an incentive to produce "by tightening the provisions of the basic order with regard to the cancellation of underage."

Thus, the net purpose of the commission order is to require the production and purchase of the "assigned allowable" by making prohibitive the economic consequences facing the pipeline purchasers for not doing so, *viz.*, the permanent cancellation of their right to purchase from their connected reserves in the Kansas Hugoton Field for which assigned allowables had previously been assigned.

The district court looking at the same facts as were presented to the commission, specifically found that the order would induce increased production from the field, and found that "[a]s a practical matter, the change in '(p)' will . . . cause a change in the 'mix' of natural gas

which pipelines transport for sale many miles away."

Thus, the district court made the basic finding of invalidity, but tried to avoid it by concluding that since the KCC order deals with the producers of natural gas, it falls within the specific exemption of the Natural Gas Act. This coincides with the commission's position that the obligations imposed to file applications for reinstatement are on the producers not the purchasers, and that the order deals solely with conservation matters.

But under the cloak of the "producing or gathering" exemption in the Natural Gas Act, under the pretense of promulgating a conservation regulation under reserved police powers, the Kansas Corporation Commission has in reality promulgated a regulation *the indirect result of which, and the precise purpose of which, is to invade and infringe upon the exclusive jurisdiction of FERC to regulate comprehensively and effectively the transportation and sale of natural gas, and to achieve the uniformity of regulation which was an objective of the Natural Gas Act. Northern Gas Co. v. Kansas Comm'n*, 372 U.S. 84.

The *Northern* case is a landmark decision. It arose out of "ratable take" orders by the Kansas Corporation Commission requiring a pipeline purchaser to purchase gas from a producer in no higher proportion to the allowables than from the wells of other producers. The U.S. Supreme Court held that the orders invaded the exclusive jurisdiction which the Natural Gas Act had conferred upon the Federal Power Commission over the sale and transportation of natural gas in interstate commerce for resale. The court specifically held:

> "Moreover, any readjustment of purchasing patterns which such orders might require of purchasers who previously took unratably could seriously impair the Federal Commission's authority to regulate

the intricate relationship between the purchasers' cost structures and eventual costs to wholesale customers who sell to consumers in other States. This relationship is a matter with respect to which Congress has given the Federal Power Commission paramount and exclusive authority. See *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591, 610 [, 88 L.Ed. 333, 64 S.Ct. 281 (1944)]. The prospect of interference with the federal regulatory power in this area is made even more acute by the fact that criminal sanctions imposed by the state statute for noncompliance fall upon such purchasers and not upon the local producers. Therefore, although collision between the state and federal regulation may not be an inevitable consequence, there lurks such imminent possibility of collision in orders purposely directed at interstate wholesale purchasers that the orders must be declared a nullity in order to assure the effectuation of the comprehensive federal regulation ordained by Congress." 372 U.S. at 92.

But the commission says that since this is a conservation matter reserved to the states under the production or gathering exemption (15 U.S.C. § 717[b] [1982]), and because it is not directed to pipeline purchasers, but rather only to producers, *Northern* does not apply. The answers to these contentions are (a) this is not really a conservation matter because the only viable testimony in the record shows clearly that waste will be caused, not prevented, by the orders, and that correlative rights will be violated not protected by the order; (b) even if the foregoing were not true, and irrespective of whether there is a reasonable state purpose to be served by the order, it is invalid because the Natural Gas Act and FERC jurisdiction thereunder is comprehensive, and the Act's application from state to

state will not depend upon kaleidoscopic variations in state law; (c) even if the order be not directed at purchasers, its indirect effect is to cause a modification in the interstate mix of gas on the Northwest Central System (as the district court found), and this is enough to tip it into constitutional invalidity.

First, the order will cause waste, not prevent it. "The dominant purpose of the Gas Conservation Statute is to prevent waste," *Colorado Interstate Gas Co.*, 192 Kan. at 25. But the undisputed testimony of Lester Wilkonson, the reputed expert on the Hugoton Field, is that the order may cause waste by inviting damaging water incursion as a result of a severe pressure drop, which might result in waste in the ground because of loss of communication with the gas reservoir.

Moreover, the commission practices of setting allowables in excess of the actual market demand have created rampant discrimination between the wells in the field. Thus, some wells such as Mesa's wells connected to KP&L with a higher proportionate intrastate market demand, have been permitted to produce a higher proportionate part of their reserves than the majority of wells in the field connected to the interstate pipelines, such as Northwest Central and others, which have a plummeting market and no place to put the gas. The Mesa acreage adjoins that from which Northwest Central purchases. Therefore, the result of cancellation under this order will be to cement for all time that discrimination, and this will no longer permit the corrective or compensatory drainage which was the hallmark of the prior commission order for years. KP&L's intrastate customers will benefit, and Northwest Central interstate customers will be prejudiced. Compare *Penna. v. West Virginia*, 262 U.S. 553, 67 L.Ed. 1117, 43 S.Ct. 658 (1923), where the attempt to withdraw a large volume of gas from an established interstate commerce current so as

to preferentially benefit local consumers in the state where the gas was produced was an unconstitutional interference with interstate commerce.

The commission tries to contend that there is a viable conservation purpose served by this order, but simply calling the order a conservation order does not make it one. The fact remains that the purpose of the order and its effect, indirect or otherwise, is to change the interstate gas mix by inducing more Kansas gas to be taken.

> ". . . 'Acts generally lawful may become unlawful when done to accomplish an unlawful end, *United States v. Reading Co.*, 226 U.S. 324, 357, and a constitutional power cannot be used by way of condition to attain an unconstitutional result.' *Western Union Telegraph Co. v. Foster*, 247 U.S. 105, 114." *Gomillion v. Lightfoot*, 364 U.S. 339, 347-48, 5 L.Ed.2d 110, 81 S.Ct. 125 (1960).

The Natural Gas Act is a comprehensive scheme of federal regulation of "all wholesales of natural gas in interstate commerce, whether by a pipeline company or not and whether occurring before, during, or after transmission by an interstate pipeline company." *Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672, 682, 98 L.Ed. 1035, 74 S.Ct. 794 (1954); *Northern Gas Co. v. Kansas Comm'n*, 372 U.S. at 91.

The Kansas Supreme Court has sustained the ratable take order, although recognizing that it applied to purchasers, because the object of the Kansas conservation statute (K.S.A. 55-703) could not be accomplished "unless that taker or purchaser can be controlled." *Northern Natural Gas Co. v. State Corporation Commission*, 188 Kan. at 360. But the U.S. Supreme Court had no trouble with this. Merely because some of the incidences of the order relate to production and gather-

ing does not bring the order into the ambit of the exemption, where other incidences of the order impact directly or indirectly upon transportation and wholesales of natural gas in interstate commerce.

Since the power of Congress under the Supremacy Clause is supreme, it is up to the State of Kansas to mold its policy of regulation of production and gathering so as not to impinge upon the exclusive jurisdiction of FERC over interstate transportation and wholesales.

The U.S. Supreme Court in *Northern* said:

> "The Natural Gas Act precludes not merely *direct* regulation by the states of such contractual matters . . . .
>
> "The federal regulatory scheme leaves no room either for direct state regulation of the prices of interstate wholesales of natural gas . . . or for state regulations which would indirectly achieve the same result." 372 U.S. at 91.

Since the *Northern* case, there have been a number of additional holdings in an unbroken line of cases saying the same thing. *Public Service Com'n v. Federal Energy Reg.*, 610 F.2d 439 (6th Cir. 1979).

It is respectfully submitted the order of the KCC under attack is invalid.

APPENDIX B

Case Nos. 83 C 20
83 C 21
83 C 22
83 C 23
83 C 24

IN THE SIXTEENTH JUDICIAL DISTRICT DISTRICT COURT, GRAY COUNTY, KANSAS CIVIL DEPARTMENT

NORTHERN NATURAL GAS COMPANY; K N ENERGY, INC.; NORTHWEST CENTRAL PIPELINE CORPORATION; AMOCO PRODUCTION COMPANY; and COLORADO INTERSTATE GAS COMPANY,
Petitioners

vs.

THE STATE CORPORATION COMMISSION OF THE STATE OF KANSAS, MICHAEL LENNEN, Chairman, RICHARD C. (PETE) LOUX, Commissioner, PHILLIP R. DICK, Commissioner, and their respective Successors in Office
Respondents

JOURNAL ENTRY OF JUDGMENT

NOW on this 7th day of November, 1983, this matter comes on for consideration of the Petitions for Judicial Review filed by the captioned petitioners herein; Mark H. Adams II, Wichita, Kansas, appearing on behalf of Northern Natural Gas Company; John Cary, Oklahoma City, Oklahoma, and Mark H. Adams II, appearing on behalf of Northwest Central Pipeline Corporation; Timothy E. McKee, Wichita, Kansas, appear-

ing on behalf of K N Energy, Inc.; Timothy E. McKee, Wichita, Kansas and Kim Conklin, Colorado Springs, Colorado, appearing on behalf of Colorado Interstate Gas Company; Ralph R. Brock, Wichita, Kansas, appearing on behalf of Cabot Petroleum Corporation, Northern Pump Company, Graham-Michaelis Corporation and Kansas Petroleum, Inc.; Glenn D. Young, Jr., Wichita, Kansas, appearing on behalf of Amoco Production Company; Richard C. Byrd, Ottawa, Kansas, appearing on behalf of Mesa Petroleum Co.; Charles H. Apt III, Wichita, Kansas, appearing on behalf of Panhandle Eastern Pipeline Company; Gregory J. Stucky, Wichita, Kansas, appearing on behalf of The Southwest Kansas Royalty Owners Association and Patricia A. Gorham, Topeka, Kansas, appearing on behalf of the State Corporation Commission of the State of Kansas.

After having reviewed the record on appeal and all of the evidence and exhibits submitted therein; having considered the briefs of the parties and the suggested findings of fact and conclusions of law and having considered arguments of counsel and being duly advised in the premises, the Court, on November 21, 1983, made the following findings of fact and reached the following conclusions of law:

FINDINGS OF FACT

1. Petitioners, Northern Natural Gas Company, Northwest Central Pipeline Corporation, Colorado Interstate Gas Company, K-N Energy, Incorporated, and Amoco Production Company, have filed their petitions for judicial review in this Court from the Corporation Commission's Order dated February 16, 1983, which amended paragraph (p) of the Basic Order for the Kansas-Hugoton Gas Field. Petitioners had heretofore timely filed their petition

for rehearing and the petitions in this Court were duly and timely filed upon their hearing being denied. This Court has jurisdiction of the issues raised therein. Mesa Petroleum Co., Panhandle Eastern Pipeline Co., Southwest Kansas Royalty Owners Association, Cabot Petroleum Corp., Northern Pump Co., Graham-Michaelis Corp., and Kansas Petroleum, Inc. were granted the status of intervenors in the present action.

2. The Hugoton Gas Field is considered to be one of the largest known reservoirs of natural gas in the world, spanning approximately 160 miles north and south and approximately 72 miles east and west of its widest point. The field covers portions of 9 counties in the southwest corner of Kansas, including Gray County, which is known as the Kansas-Hugoton Gas Field and the field extends through the Oklahoma Panhandle into several counties of northern Texas.

3. There are presently more than 4,000 producing wells in the Kansas-Hugoton Gas Field and the field has long been considered to be fully developed.

4. Major purchasers of gas produced in the Kansas-Hugoton Field are Northern Natural Gas Company, Northwest Central Pipeline Corporation, Colorado Interstate Gas Company, Kansas Power and Light Company, Kansas-Nebraska Natural Gas Company and Panhandle Eastern Pipeline Company.

5. The purchaser, Kansas Power and Light is connected mostly to wells produced by Mesa Drilling Company and its demand for intrastate market is stable and currently greater on a connected deliverability basis than that of the other companies. The Mesa Wells connected to KP&L are over-produced. While, on the other hand, the wells

connected to the Petitioners in this action are under-produced.

6. Five other pipelines, which would be Northern Natural Gas Company, K N Energy Company, Northwest Central Pipeline Company, Amoco Production Company and Colorado Interstate Gas Company, are also interstate pipeline purchasers. To varying degrees in recent years, their markets have declined severely because of conservation, Federal intervention, competition with alternate fields and the recession. In 1982, natural gas sales fell by one-third and the Kansas-Hugoton Field production fell by 42.6%.

7. Due to the varying market conditions of the purchasers in the field, divergent rates of takes or purchases are inevitable. Throughout the regulated life of the field, every purchaser has gone through periods of overproduction of allowances, and of periods of making up prior underproduction and the various purchasers are not in the same phase of the cycle at the same time.

8. Due to the present economic conditions and loss of gas markets and the terminations of market demands for the field by the Commission commencing in 1975, the field, as a whole, presently, is underproduced. As of September 1, 1982, the current noncancelled underage was 204.5 billion cubic feet (Bcf) which was an increase of approximately 60 Bcf from September 1, 1981, with the situation getting worse. The underage cancelled during the period from January 1, 1967, to August 1, 1982, which remained unreinstated as of September 1, 1982, was approximately 314 Bcf. As shown by the monthly Proration Reports for the field issued by the Commission, an additional 86.9 Bcf of the underage has

been cancelled for the period from September 1, 1982, to September 1, 1983.

9. In order to maintain some type of orderly development of this field, the Commission first issued its basic order for the Hugoton Gas Field in Kearney, Finney, Grant, Morton, Haskell, Stevens, Seward, Stanton, Gray and Hamilton County, Kansas, on March 19, 1944, pursuant to its statutory authority. As part of the basic Proration Order for the Kansas-Hugoton Field a deliverability formula was established for use in the assigning of allowables to the wells producing from the Kansas-Hugoton Field. To allow some flexibility to the producers in the field the Commission established production tolerances for over and underproduction of the allowable, which is set by the Commission as part of the market demand proceedings. The tolerance provisions are set forth in Paragraph "P" of the basic orders.

10. An order for a general investigation of the basic Proration Order for the Kansas-Hugoton Field was properly issued on March 15, 1982. The problem concerns correlative rights which were being violated, but this does not result from the assignment of the allowable, but rather from the failure of producers and pipeline purchasers to take production from the field. The lack of incentive to produce is supported by the extreme tolerance provisions of the Proration Order and results in depriving some operators of the opportunity to participate in the given market. Paragraph "P", prior to the change, did not provide operators sufficient incentive to produce gas.

11. The change in paragraph "P" tightens the provitions of the Basic Order with regard to cancellation

of "Underages". This will, in turn, affect the right to produce and purchase heretofore allowed gas from the field. It will, however, provide greater incentive for operators to produce and should induce increased production in the field.

12. As a practical matter, the change in "P" will cause some permanent loss of underages (allowables) due to market conditions and will also cause a change in the "mix" of natural gas which pipelines transport for sale many miles away.

CONCLUSIONS OF LAW

1. The Commission has, from the beginning of the Proration, recognized the standing of the pipeline purchasers to institute and participate in proceedings, to appear before it, and to appeal from these rulings to the Kansas Courts. Thusly, their appeals should not be summarily dismissed.
2. Since the Basic Proration Order for Kansas-Hugoton Field was first issued in 1944, the Commission has, from time-to-time, amended the order with regard to provisions relating to a cancellation of the underage in the field. The amendments have been necessitated by changes in field conditions and the market demand for natural gas produced in the field. The modification of the rules of the field is in keeping with the responsibility of the K.C.C. to regulate the taking of natural gas in order to prevent inequitable or unfair taking of gas and prevent unreasonable discrimination in favor of, or against, any one producer in the field.
3. The Commission's Order of February 16, 1983, applies to all producers in the field and is for the purpose of preventing unfair and inequitable taking of gas by any person. The order is in keeping

with the Commission's responsibility set forth in K.S.A. 55-703.

4. The correlative rights of a producer is the right to participate in a given market for a given period of time. The Commission's responsiblity to protect the correlative rights is fulfilled when operators are permitted to currently produce their assigned allowable. However, when an operator fails to produce that allowable over a period of time and an underage is accrued to the extent, it is in the excess of that allowed by the provisions of the Basic Proration Order, the Commission has the authority to order such underage permanently cancelled.
5. Since this K.C.C. Order deals with the producers of natural gas it falls within the specific exemption of the Federal Natural Gas Act. This exemption allows the State to regulate the "production or gathering" of natural gas.
6. The Commission's Order changing Paragraph "P" of the Basic Proration Order of Hugoton Field is reasonable and lawful and is based on substantial, competent evidence and the order of the Commission dated February 16, 1983, and the Order on Rehearing dated April 14, 1983, are hereby affirmed.

IT IS, THEREFORE, ORDERED, ADJUDGED AND DECREED that the Order of the State Corporation Commission dated February 16, 1983, and the Order on Rehearing dated April 14, 1983, are hereby affirmed.

On November 2, 1983, this Court entered an Order staying until January 30, 1984, the requirement of the Commission's Order of February 16, 1983, for the filing of applications for reinstatement of underage

cancelled prior to January 1, 1975, by reason of the pendency of these judicial review proceedings. The Order of this Court of November 2, 1983, is reaffirmed.

IT IS SO ORDERED.

DISTRICT JUDGE

APPROVED:

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APPENDIX C

Docket No. C-164

THE STATE CORPORATION COMMISSION OF THE STATE OF KANSAS CONSERVATION DIVISION

BEFORE COMMISSIONERS: RICHARD. C. (PETE) LOUX, Chairman, JANE T. ROY, PHILLIP R. DICK

IN THE MATTER OF ESTABLISHING RULES AND REGULATIONS RELATING TO THE PRODUCTION, SALE, AND CONSERVATION OF NATURAL GAS IN THE HUGOTON FIELD IN KEARNY, FINNEY, GRANT, HASKELL, MORTON, STEVENS, SEWARD, STANTON, GRAY AND HAMILTON COUNTIES, KANSAS.

ORDER

NOW, the above-captioned matter comes on for consideration and determination before the State Corporation Commission on the general investigation into the provisions of the basic order for the Hugoton Gas Field, specifically the provisions of Paragraph (P) of the basic order. This matter comes before Commissioners, Richard C. (Pete) Loux, Chairman; Jane T. Roy; and Phillip R. Dick.

The hearing was held for the purpose of considering modification of the commission's existing policy set forth in Paragraph (P) of the basic Proration Order with regard to over and under production from the field. The hearing was held November 3, 1982, at Wichita Royale, 125 N. Market, Wichita, Kansas. The appearances were as follows:

Bernard E. Nordling, Hugoton, Kansas, Dale Stucky, and Greg Stucky, Wichita, Kansas, on behalf

of Southwest Kansas Royalty Owners Association.

Timothy E. McKee, Wichita, Kansas, and Tim Conklin, Colorado Springs, Colorado, on behalf of Colorado Interstate Gas Company (or Colorado Interstate).

Jerome E. Jones, Wichita, Kansas, on behalf of Mobil Oil Corporation and Northern Natural Gas Producing Company (or Northern)

Jerome E. Jones and Raymond Brummett, Wichita, Kansas, on behalf of the Federal Land Bank of Wichita.

Jerome E. Jones, Wichita, Kansas, on behalf of Anadarko Production Company (or Anadarko).

B. J. Heckert and Glenn D. Young, Wichita, Kansas, on behalf of Amoco Production Company (or Amoco).

Gary Paulson, Denver, Colorado, on behalf of Amoco Production Company.

Stanford Smith, and Stanford Smith, Jr., Wichita, Kansas on behalf of Cities Service Company (or Cities).

Patrick J. McCarthy, Omaha, Nebraska, Mark H. Adams, II and Don Bostwick, Wichita, Kansas, on behalf of Northern Natural Gas Company.

John Cary, Oklahoma City, Oklahoma, Mark H. Adams, II, and Don Bostwick, Wichita, Kansas, on behalf of Cities Service Gas Company.

James Daross, El Paso, Texas, Don Bostwick, and Mark Adams, II, Wichita, Kansas, on behalf of El Paso Natural Gas Company (or El Paso).

Richard C. Byrd, Ottawa, Kansas, Jeff Sharder, Amarillo, Texas, for Mesa Petroleum Company (or Mesa).

John Rosenberg and James L. Grimes, Topeka, Kansas, on behalf of Kansas Power and Light Company (or KP&L).

Ralph R. Brock, Wichita, Kansas, on behalf of Cabot Petroleum Corporation, Northern Pump Company, Graham-Michaelis Corporation and Kansas Petroleum Inc.

William L. Robinson, Kansas City, Missouri, and Jack Glaves, Wichita, Kansas, on behalf of Panhandle Eastern Pipeline Company (or Panhandle).

Robert Martin, Timothy E. McKee, Wichita, Kansas, and Robert Miller, Denver, Colorado, on behalf of Kansas-Nebraska Natural Gas Company (or Kansas-Nebraska).

Patricia A. Gorham and Susan Ellis, Assistants General Counsel, on behalf of the Commission Staff and the public generally (of Staff).

An letter was submitted to the Commission on behalf of ARCO Oil and Gas Company in opposition to Staff's recommendations.

INTRODUCTION

This order concludes proceedings held before the Commission November 3 and 4, 1982, as a part of the general investigation into the provisions of the basic Proration Order for the Hugoton Gas Field. The issue addressed in these proceedings was whether or not changes should be made in the provisions of Paragraph (P) of the basic Proration Order with respect to over and under production from the field, specifically the issue concerning reinstatement of cancelled underage.

In its order of September 20, 1982, the Commission scheduled a hearing to begin November, 3, 1982, at the Wichita Royale, 125 N. Market, Wichita, Kansas. Staff was required to prefile testimony on or before October 6, 1982. All other parties were required to prefile testimony by October 20, 1982.

The following parties prefiled direct testimony: 1. Ron Cook, Consulting Petroleum Engineer on behalf of the Commission Staff. 2. William E. Feemster, Staff Gas Sales Representative, on behalf of Amoco Production Company. 3. Gary D. Hancock, General Manager of Supply, Production and Evaluation, on behalf of Northern Natural Gas Company. 4. Lester Wilkonson, Consulting Petroleum Engineer, on behalf of Cabot Petroleum Corporation, Northern Pump Company, Graham-Michaelis Corporation and Kansas Petroleum Inc. 5. S. Javaid Anwar, Petroleum Engineer, on behalf of Cabot Petroleum. 6. Michael S. Daugherty, Manager of Acquisitions and Planning, on behalf of Mesa Petroleum. 7. Jimmy W. Mogg, Manager of Forecasting, on behalf of Panhandle Eastern Pipeline Company. 8. Robert McClure Danos, Senior Vice-President in charge of Gas Line Production, on behalf of Kansas-Nebraska Natural Gas Company, Incorporated. 9. Donald A. Hutton, Manager of Gas Supply Services, Kansas-Nebraska Natural Gas Company, Incorporated. Twenty-one exhibits were submitted in connection with the testimony.

At the close of testimony, Amoco Production Company requested leave to file a brief in support of its position on the issue of reinstatement of cancelled underage. The commission granted leave to file briefs not later than November 30, 1982. The deadline for filing briefs was later extended to December 10, 1982. Briefs were submitted on behalf of Mesa, Panhandle, Amoco, Northern Natural, Kansas-Nebraska, Cities Service Gas, and Colorado Interstate.

FINDING OF FACT AND CONCLUSIONS OF LAW

The Commission, being duly advised in the premises, and having given due consideration to the

record and files and all the evidence related thereto, makes the following findings and conclusions:

1. This Commission has been given jurisdiction to regulate the production of natural gas from a common source of supply in order to insure the orderly development of and production of natural gas pursuant to K.S.A. 1981 Supp. 55-703. Whenever the available production from the common source of supply is in excess of the market demand and the Commission has exercised its jurisdiction over the common source of supply, a producer is allowed to produce only a portion of the gas that may be produced without waste and to satisfy the market demand and to currently produce proportionately with other developed leases.

2. The Commission issued its basic order for the Hugoton Gas Field in Kearny, Finney, Grant, Haskell, Morton, Stevens, Seward, Stanton, Gray and Hamilton Counties, Kansas, on March 19, 1944, pursuant to its authority under Chapter 55 of the Kansas Statutes Annotated. As a part of the basic Proration Order for the Kansas Hugoton Field, a deliverability formula was established for use in assigning allowables to the wells producing from the Kansas Hugoton Field. To allow some flexibility to the producers in the field, the Commission established production tolerances for over and under production of the allowable as set by the Commission as part of the market demand proceedings. The tolerance provisions are set forth in Paragraph P of the basic order.

3. The order for a general investigation into the provisions of the basic Proration Order for the Kansas Hugoton Field was properly issued on March 15, 1982, pursuant to the Kansas Statutes. Notice of the November 3rd hearing was published in the Wichita

Eagle Beacon Newspaper at least ten days prior to the hearing as required by law. Notice was given to all known interested parties.

4. The issue addressed at this hearing concerns whether changes should be made in Paragraph (P) of the basic Proration Order for the Hugoton Gas Field as it relates to over and under production from the field.

5. Paragraph (P) provides: any well with an adjusted deliverability in excess of 300 Mcfd may accumulate overproduction or underproduction equivalent to six times the amount of the current allowable assigned to the well the preceding January before either being shut in due to excessive production or having the accumulated underproduction cancelled. Any well with an adjusted deliverability of less than 300 Mcfd may accumulate overproduction or underproduction equivalent to nine times the amount of current allowable assigned to the well for the preceding January before being shut in or having such accumulated underproduction cancelled. Any underage cancelled pursuant to the provisions of Paragraph (P) shall not be considered in determining the future production of a well unless otherwise determined by the Commission.

Paragraph (P) further provides: underages cancelled within the provisions of this paragraph will be reinstated upon verified application showing that the wells are in an overproduced status; that the purchaser is willing and able to take the amounts of gas sought to be reinstated; and that the length of time proposed by the applicant for the production of the amounts of gas to be reinstated is reasonable under the circumstances.

6. The Commission Staff made the following recommendations: (1) that the provisions of Paragraph (P) be amended to provide that any order reinstating cancelled

underage issued prior to January 1, 1983, remain in full force and effect. If a well is underproduced at the end of the time period set forth in the order, the remaining reinstated underage should be cancelled permanently. If the well is overproduced at the end of the time period set forth in the order up to a twelve month extension in which to make up the remaining reinstated underage may be granted by the Commission upon application to the Conservation Division.

(2) Effective January 1, 1983, any well which has underage cancelled prior to that date shall have that underage cancelled permanently unless an application to reinstate the underage is filed within two years or by January 1, 1985.

(3) After January 1, 1983, any well that has accumulated underproduction in excess of that amount allowed by the Hugoton basic order, shall have all underage cancelled. After all the underage is cancelled the well status will be zero and the well will again accumulate over/under production according to the provisions of the basic order. An operator shall have two years from the time the underage is cancelled to file an application to reinstate all or any part of the cancelled underage. If the Commission issues an order granting reinstatement and the well is underproduced at the end of the time period set froth in the order, the remaining reinstated underage shall be cancelled permanently. The operator shall have an opportunity to file an application and show cause why the underage should not be permanently cancelled. If the well is overproduced at the end of the time period set forth in the order an extension of twelve months in which to produce the cancelled underage may be granted by the Commission upon application to the Conservation Division.

(4) That any minimum allowable well which has

underage cancelled should be classified as a limited well. A limited well shall receive an allowable based on the well's actual adjusted deliverability rather than receiving the minimum allowable of 50 Mcfd. If the well has a zero deliverability, the well will be permitted to produce up to a maximum of 50 Mcfd until the well receives a calculated deliverability. Reinstatement of cancelled underage for a limited well should be granted under the same conditions as for any other well in the field.

Witnesses for Cabot Petroleum, Northern Pump Company, Graham-Michaelis and Kansas Petroleum opposed any change in the provisions of Paragraph (P) of the basic order. Witness Wilkonson recommended that all underage, both current and cancelled, be placed back on the monthly proration report to allow purchasers and other interested parties an opportunity to determine the true status of the field. Mr. Wilkonson testified that the only solution to the underage problem in the field is the production and taking of gas.

In Mr. Wilkonson's opinion, Staff's proposal would not provide an incentive for production. Mr. Wilkonson testified that to cause underage to be made up in too short a time would not permit the reservoir to function as it should. He recommended that a well should be permitted to make up cancelled underage over the same period of time as the cancellation occurred.

Mr. Wilkonson sponsored exhibits 8 and 9 for the purpose of showing the presence of drainage occurring from areas of high pressure (under produced wells) to areas of low pressure (wells currently producing their allowable). He testified that the permanent cancellation of underage would prohibit some wells from obtaining compensating drainage. He concluded that the permanent cancellation of underage would preclude the balancing of correlative rights.

Mr. Gary Hancock, witness for Northern Natural Gas recommended no change in Paragraph (P) of the basic Proration Order. The witness suggested instead that the monthly nominations be adjusted for prior months actual runs and used as the current allowable.

Witnesses for Kansas-Nebraska Natural Gas Company and Amoco Production Company recommended no change in the provisions of Paragraph (P).

Mr. Robert Danos and Donald Hutton testified on behalf of Kansas-Nebraska's position. Mr. Danos testified that the Staff's plan provided too short a period to allow Kansas-Nebraska to make up its underages. Mr. Hutton testified that in his opinion, the Staff's proposal would not allow Kansas-Nebraska wells an opportunity to produce their share of market requirements.

Panhandle Eastern Pipeline Company supported a change in the provisions of Paragraph (P). Panhandle's witness, Mr. Jimmy Mogg, testified that there is sufficient cancelled underage to cause concern whether correlative rights are being protected under current present reinstatement procedures. He testified that the success of proration depends upon the timely production of allowables. If operators are permitted to ignore allowables, there is no real proration in the field and correlative rights will be violated. The witness recommended that the effective date for changes in the Paragraph (P) of January 1, 1983, be deferred to no sooner than July 1, 1983, or until six months after the order becomes effective to allow purchasers to prepare for implementation. It was further recommended that the period for reinstating cancelled underage be extended to three years, and that an additional year extension be granted automatically if the well is in an overproduced status at the end of the time period. Mr. Mogg recommended that any overproduction should qualify an operator for

reinstatement. He recommended that all wells be treated the same rather than making a distinction with regard to wells with reinstatement orders before 1983 and those wells with reinstatement after 1983. Finally, it was recommended that if a minimum well category is to be put into effect, the category should apply only to those wells physically unable to produce 50 Mcf per day.

Mesa Petroleum's witness Mr. Michael S. Daugherty, testified in support of a change in the provisions of Paragraph (P) of the basic order. Mesa recommended that only one year be allowed for an operator to apply for reinstatement of cancelled underage for wells having underage cancelled after July 1, 1983. The witness further recommended that only one year instead of two years be allowed to make up reinstated underage. With these two exceptions Mesa Petroleum supported the recommendation made by Staff.

7. Since the basic Proration Order for the Kansas Hugoton Field was first issued in 1944, the Commission has from time to time amended the order with regard to the provisions relating to cancellation of underage in the field. The amendments have been necessitated by changes in field conditions and the market demand for natural gas produced from the field. The modification of the field rules is in keeping with the responsibility of this Commission to regulate the taking of natural gas to prevent inequitable or unfair taking of gas and prevent unreasonable discrimination in favor of or against any one producer in the field.

8. Arguments have been made by parties to the hearing that the Commission has no authority to permanently cancel underage because such cancellation may result in a violation of correlative rights which the Commission is mandated to protect. The Commission cannot agree. The correlative rights of a producer is the

right to participate in a given market for a given period of time. The delivery formula established to determine allowables in the field is designed to protect the rights of producers by assigning allowables to give them the opportunity to partipate in a given market. The record is clear that the parties agree that the existing deliverability formula is considered the best one possible for use in the field. The Commission's responsibility to protect correlative rights is fulfilled when operators are permitted to currently produce their assigned allowable. When an operator fails to produce that allowable over a period of time and the underage is accrued to the extent that it is in excess of that allowed by the provisions of the basic proration order, the Commission has authority to order such underage permanently cancelled.

The Commission finds that the problem with correlative rights violations does not result from the assignment of the allowable but rather from the failure of producers and pipelines to take production from the field. Currently, Paragraph P of the Proration Order gives producers an adequate opportunity to produce their allowables on a timely basis. Those operators producing their allowable may have wells with lower pressures than the average wells in the field and consequently may receive a smaller allowable than those operators not producing their allowables. The lack of incentive to produce afforded by the extreme tolerance provisions of the Proration Order results in depriving some operators of the opportunity to participate in the given market. Since the Commission has the responsibility to prevent unreasonably discrimination against any one producer in the field, the Commission has the responsibility to correct this situation. It is the purpose of this order not to restrict production of gas but to encourage it.

The evidence clearly demonstrates that Paragraph

P does not provide operators sufficient incentive to produce gas. Ron Cook testified that as of September 1, 1982, the current underage in the field was 204.5 Bcf as compared to 144.5 Bcf on September 1, 1981. There has been over 508 Bcf of underage cancelled from January 1, 1967 to August 1, 1982, with only 194 Bcf of underage reinstated during that period.

9. Having addressed the evidence related to correlative rights violations, the additional evidence introduced is interpreted by the Commission to relate to two general issues:

(1) Will Staff's plan provide an incentive to operators to produce their allowables; and,

(2) Is there a better plan to encourage production of current allowables than presented by Staff.

Within these confines, the issue presented in this docket becomes clear: upon the evidence presented in this proceeding, what is the best method to encourage ratable taking of assigned allowables?

The Commission is persuaded that an incentive for operators to produce is created by tightening the provisions of the basic order with regard to the cancellation of underage. However, any change in policy should include a reasonable opportunity to reinstate and produce cancelled underage before such underage is permanently cancelled. The general support of Staff's plan by Mesa and Panhandle evidence the fact that limiting the period under which underage may be reinstated and produced may induce production in the field. As Mesa notes in its brief, that the plan will be an inducement for increased production is also evidenced by some producer's objections to the changes proposed.

The Commission is not persuaded by the comments of witnesses, such as Lester Wilkonson, that the Staff

proposal to tighten the cancellation policy will solve the underproduction problem only on paper. The Commission finds that while the adoption of a stricter policy regarding cancelled underage is not guaranteed to increase production, the existing situation in the field warrants all reasonable efforts to do so.

The Commission finds that adjusting monthly nominations for prior actual runs will compound the violation of correlative rights of those producers who wish to produce their current allowable. Adjusting monthly nominations for prior runs would cause allowables to be adjusted downward. In effect, the adjustment would diminish the right of some producers to participate in the current market, thus violating their correlative rights. For this reason, the proposal of Northern Natural Gas is rejected.

Similarly, the proposals of Kansas-Nebraska Natural Gas Company and Amoco Production Company are rejected, as these companies recommended no changes in the provisions of Paragraph P. Mr. Wilkonson and others testified that the only solution to the problem in the field is the production and taking of gas by the pipelines. It is clear that, under the present provisions, production is not adequately occurring and underages are accumulating. Therefore, some change is necessary. The evidence sponsored by staff, Mesa Petroleum and others demonstrate that the current provisions do not induce the production necessary to balance the field and protect correlative rights.

The Commission finds it is in the public interest to allow operators a reasonable period in which to reinstate and make up cancelled underage. This period must be reasonable while it cannot be so long as to endanger the correlative rights of those producers who have consistently produced their allowables, and it cannot be so

short as to cause waste. The Commission notes that the evidence presented in respect to time restraints for production of underage runs the range from no time limit whatsoever to produce underage to a one year limitation. The Commission feels that between these two proposals exists a reasonable time period in which cancelled underage must be reinstated and produced.

10. It is estimated that as of September 1982 there was approximately 314 Bcf of cancelled underage in the field. As indicated by the evidence, this underage dates back at least to the 1960's. The testimony of Mr. Hancock, Mr. Feemster, Mr. Anwar and Mr. Danos shows that individual wells in the field have suffered underage cancellation prior to 1970. The Commission believes it is in the public interest and in the interest of the producers to clear up this underage dilemma as much as possible. In the future, it will be practically impossible to ascertain the balance of the field if underages relate backward in perpetuity. Some sort of benchmark is necessary if the Commission is to effectively balance takes from the field. Given the current high volume of cancelled underage, the Commission finds that it is doubtful that much of the underage cancelled prior to 1975 will be able to be produced. Moreover, the Commission notes that the evidence shows that during 1974, cancelled underage in the field was at its lowest level relative to other years. Further, the Commission notes that prior to 1975, large volumes of cancelled underage were reinstated. Therefore, the Commission finds that January 1, 1975 would be a reasonable benchmark from which to address old underage. The Commission does however wish to give the operators ample opportunity to reinstate and produce as much of this old underage as is possible. For these reasons, the Commission finds that for underage cancelled prior to January 1, 1975, an operator may request that the Com-

mission reinstate all or any portion of such cancelled underage up to December 31, 1983. The request for reinstatement of this underage shall not be contingent upon the well being in an overproduced status. Any underage cancelled prior to January 1, 1975 for which reinstatement is not requested by the December 31, 1983 date, shall be permanently cancelled.

Underage cancelled during the period of January 1, 1975 through December 31, 1982 may be reinstated if the operator requests such reinstatement prior to December 31, 1985. Provided, however, the well shall be in an overproduced status at the time the request for reinstatement is made. This is in keeping with past Commission policy regarding reinstatement of underage. The operator shall be allowed up to 60 months in which to produce any reinstated underage. Any underage not requested to be reinstated by the December 31, 1985 date shall be cancelled permanently.

For underage cancelled after December 31, 1982, an operator shall have three years from the date of cancellation in which to request reinstatement. The well for which reinstatement is requested shall be in an overproduced status at the time the application for reinstatement is filed. Any reinstatment underage not produced at the end of the time period set forth in the Commission's order shall be cancelled permanently.

All applications for reinstatement shall state (1) that the well is physically capable of producing the reinstated underage in addition to the current allowable, (2) the length of time requested to make up the reinstated underage, which in no event shall be more than 60 months, (3) that the purchaser is ready and willing to take the additional gas, and (4) the month, year and volumes of underage cancelled.

Upon the filing of an application and a showing of

the existence of exceptional circumstances such as an act of God, the Commission may order the underage not be permanently cancelled.

11. Any existing orders of this commission reinstating cancelled underage and allowing certain time periods for the production of such reinstated underage shall remain in full force and effect as set forth in such order. If the underage requested to be reinstated is not produced by the end of the time period allowed for production as set forth in the order, such underage shall be permanently cancelled.

12. As a part of its recommendations to the Commission, staff proposed that a limited well category be included in the provisions of the basic Proration Order. The limited wells would consist of those wells which receive a minimum allowable and have had underage cancelled. It was Staff's position that this category would set the allowables for such wells at a more realistic rate and prevent additional cancelled underage. While the Commission finds that such a category may benefit those wells and the field as a whole, we find that the category should not be adopted at this time. The inclusion of such category in the basic Proration Order would require further investigation and review by this Commission.

13. The Commission finds that it is in the interest of the purchasers, operators and the general public to provide additional information as to the status of the wells producing from the Kansas Hugoton Field. The Commmission Staff is hereby directed to annually publish the status of all wells in the field setting forth the total underage cancelled, the underage reinstated, and reinstated underage still to be produced, as well as other pertinent information presently included in the Commission's report. This report shall indicate the

status of all wells as of December 31 of the year for which it is issued. The initial report shall be prepared and published by Staff no later than May 1, 1983.

It is, therefore by the Commission ordered:

That Paragraph (P) of the basic Proration Order for the Kansas Hugoton Field be and the same is hereby amended as follows:

For underage cancelled prior to January 1, 1975, an operator shall be allowed to request reinstatement of all or a portion of such underage any time up to December 31, 1983. The well shall not be required to be in an overproduced status to have underage reinstated. Any underage that is reinstated and not produce within the specified time limit shall be permanently cancelled.

For underage cancelled between January 1, 1975 and December 31, 1982, an operator shall be allowed to request reinstatement at any time prior to December 31, 1985. At the time an application for reinstatement is filed the well shall be in an overproduced status. Any underage not reinstated or which has been reinstated and not produced according to these prescribed time limits, shall be cancelled permanently.

For underage cancelled after December 31, 1982, an operator shall have three (3) years from the date of cancellation to request reinstatement of such underage. The well must be in an overproduced status in order for an operator to request reinstatement. Any cancelled underage not reinstated or which has been reinstated and not produced shall be cancelled permanently.

All applications for reinstatement shall state (1) that the well is physically capable of producing the reinstated underage in addition to the current allowable, (2) the length of time requested to make up the reinstated underage, which in no event shall be more than

60 months, (3) that the purchaser is ready and willing to take the additional gas, and (4) the month, year, and volumes of underage cancelled.

Upon the filing of an application and a showing of the existence of exceptional circumstances such as an act of God, the Commission may order that underage not be permanently cancelled.

The Staff is directed to annually publish the over/under status of all the wells in the Hugoton Field beginning with the status as of December 31, 1982. The initial report shall be published no later than May 1, 1983.

The Commission retains jurisdiction over the subject matter and the parties for the purpose of entering such further order or orders as may be deemed necessary.

Dated: February 16, 1983

Loux, Chmn.; Roy, Com.; Dick, Com.

Acting Executive Secretary

APPENDIX D

Docket No. C-164

THE STATE CORPORATION COMMISSION OF THE STATE OF KANSAS CONSERVATION DIVISION

BEFORE COMMISSIONERS: RICHARD C. (PETE) LOUX, Chairman, JANE T. ROY, PHILLIP R. DICK

IN THE MATTER OF ESTABLISHING RULES AND REGULATIONS RELATING TO THE PRODUCTION, SALE, AND CONSERVATION OF NATURAL GAS IN THE HUGOTON FIELD IN KEARNY, FINNEY, GRANT, HASKELL, MORTON, STEVENS, SEWARD, STANTON, GRAY, AND HAMILTON COUNTIES, KANSAS.

ORDER

NOW, the above captioned matter comes on for consideration and determination by the State Corporation Commission of the State of Kansas before Commissioners; Richard C. (Pete) Loux, Chairman; Jane T. Roy; and Phillip R. Dick.

Applications for a rehearing of the Commission's order issued in this docket, February 16, 1983, were filed on behalf of Kansas-Nebraska Natural Gas Company, Inc., Amoco Production Company, Northern Natural Gas Company, Division of Internorth, Inc., Colorado Interstate Gas Company, Panhandle Eastern Pipe Line Company, and Northwest Central Pipeline Corporatin.

The Commission, by order dated, March 4, 1983, granted the applications and scheduled a rehearing for March 17, 1983, at 2:00 p.m., at the Wichita Royale, 125 N. Market, Wichita, Kansas, for the purpose of receiving oral argument only on the issues set forth in the

applications. Notice of the rehearing was mailed to all interested parties as shown on the Commission's mailing list in this docket.

Rehearing was held pursuant to the notice. The following appearances were made:

Mark H. Adams, Jr., Wichita, Kansas, and John Cary, Oklahoma City, Oklahoma, for Northwest Central Pipeline Company (Northwest Central).

Mark H. Adams, Jr., Wichita, Kansas, and Patrick McCarthy, Omaha, Nebraska, for Northern Natural Gas Company (Northern Natural).

Glenn D. Young, Wichita, Kansas, and Robert Leo, Dener, Colorado, on behalf of Amoco Production Company (Amoco).

Timothy McKee, Wichita, Kansas, and Kim Cocklin, Colorado Springs, Colorado, on behalf of Colorado Interstate Gas Company (CIG).

Timothy McKee, Wichita, Kansas, and Robert Miller, Lakewood, Colorado, on behalf of Kansas-Nebraska Natural Gas Company, Inc. (Kansas-Nebraska).

Jack Glaves, Wichita, Kansas, and William L. Robinson, Kansas City, Missouri, on behalf of Panhandle Eastern Pipe Line Company (Panhandle).

Richard C. Byrd, Ottawa, Kansas, on behalf of Mesa Petroleum Corporation (Mesa).

Ralph Brock, Wichita, Kansas, on behalf of Cabot Petroleum, Northern Pump Corporation, Graham-Michaelis Corporation, and Kansas Petroleum, Inc., (Cabot, et al).

John Rosenberg, Topeka, Kansas, on behalf of Kansas Power and Light Company (KPL).

Jerome E. Jones, Wichita, Kansas, on behalf of Mobil Oil Corporation (Mobil) and Northern Natural

Gas Producing Company (Northern Natural Gas).

Stanford Smith, and Stanford Smith, Jr., Wichita, Kansas, on behalf of Cities Service Company (Cities).

Greg Stucky, Wichita, Kansas, on behalf of the Southwest Kansas Royalty Owners Association.

Patricia A. Gorham, Assistant General Counsel, on behalf of the Commission Staff and the Public generally (Staff).

INTRODUCTION

The applications for rehearing filed in this docket concern the Commission's order issued February 16th relating to the provisions of Paragraph (P) of the basic Proration Order for the Kansas Hugoton Field. The various applications for rehearing allege that the Commission's order is unreasonable and unlawful and that the order should be set aside. The allegations raised in the applications for rehearing can be summarized as follows:

That the Commission's order is unreasonable in that it failed to consider all the evidence in the record;

That the Commission's order is unlawful because the Commission fails to carry out its responsibility to prevent waste and protect correlative rights;

That the Commission exceeded its authority with respect to the protection of correlative rights and the prevention of waste;

That the Commission's order violates the U.S. Constitution and the Kansas Bill of Rights;

That the Commission's order is an impermissible attempt to regulate the natural gas pipelines which are under the sole jurisdiction of the FERC;

That the Commission's order amounts to retroactive rule making;

And finally that with respect to existing reinstatement orders the Commission's order is discriminatory in failing to allow additional time for making up reinstated underage in keeping with the other provisions of Paragraph (P).

The Commission having heard the arguments of the parties and after giving due consideration to the records and its files, makes the following findings and conclusions:

1. The Commission has jurisdiction to regulate the production of natural gas from a common source of supply under the provisions of K.S.A. 1981 Supp. 55-703. Pursuant to this jurisdiction, the Commission issued the basic Proration Order for the Kansas Hugoton Field in Docket No. C-164.

2. The Commission entered its order amending the provisions of Paragraph (P) of the basic Proration Order in this docket dated February 16, 1983.

3. Applications requesting rehearing of the Commission's order issued February 16, 1983, were filed on behalf of Northwest Central Pipeline Corporation, Colorado Interstate Gas Company, Amoco Production Company, Panhandle Eastern Pipe Line Company, Kansas-Nebraska Natural Gas Company and Northern Natural Gas. The applications for rehearing were timely filed pursuant to Kansas statutes and the regulations of this Commission.

4. By order issued March 4, 1983, the Commission granted the applications for rehearing. Rehearing was set for March 17, 1983, at the Wichita Royale, 125 N. Market, Wichita, Kansas, at 2:00 p.m. for purposes of oral argument only. Notice of the rehearing was mailed to all interested parties as required by law.

Applicant Northwest Central questioned the Com-

mission's authority to allow oral arguments only on an application for rehearing. The Commission's rules of practice and procedure apply to rehearings before the Commission and are applicable to actions brought under the conservation statutes. K.A.R. 82-1-235(C) specifies four different types of rehearings that may be had before the Commission. K.A.R.82-1-235(C)(3) provides for rehearing for oral argument. The Commission's procedure in this instance is clearly within its jurisdiction.

5. As a part of its application for rehearing, Northwest Central requested that certain exhibits be admitted into the record of this docket. The motion was objected to by Staff. After hearing arguments on the motion, the Commission took the motion under advisement. The Commission finds that the subject exhibits do not provide the commission with additional relevant information not previously presented. The request to be allowed to submit additional exhibits is denied.

6. The Commission has carefully reviewed and considered the contentions raised by the applications for rehearing as well as the oral arguments presented at the hearing. We are of the opinion that the order of February 16, 1983, should be affirmed with one exception.

Panhandle, Amoco, and Cities argued on rehearing that Paragraph (11) of the Commission's February 16th order, which pertains to existing orders reinstating cancelled underage, is unreasonable and discriminatory. These parties argued that under the February 16 order underage subject to a reinstatement order issued prior to February 16, 1983, is not treated equal to underage not previously reinstated. Paragraph (11) does not allow any additional time in which to produce reinstated underage other than that time set forth in the existing order.

The Commission feels that the parties make a valid objection with regard to Paragraph (11). As stated in the order, it is the Commission's intent to allow a reasonable amount of time for making up cancelled underage in the field. For all other underage, subject to compliance with the Commission's requirements, up to 60 months may be allowed in which to produce reinstated underage. It is not unreasonable to provide a similar time period for underage presently reinstated by order of the Commission.

The Commission finds that any operator with an existing order allowing reinstatement of cancelled underage may make application to the Commission for an extension of time in which to produce the reinstated underage. The additional time requested shall in no event exceed 60 months. The application for an extension of time shall state that the well is physically capable of producing the remaining underage in addition to the current allowable, the amount of reinstated underage remaining to be produced, that the purchaser continues to be able to take the additional gas, and the amount of additional time requested to produce the reinstated underage.

7. The pipeline purchasers, with the exception of Panhandle and KPL, contend that the Commission lacks the authority to amend Paragraph (P) of the basic order so as to limit the time period in which cancelled underages must be reinstated and produced. The principal arguments advanced relate to the Commission's lack of, or misinterpretation of, the authority granted to it in K.S.A. 55-703, the unlawful invasion of the authority of the FERC under the Natural Gas Act and that the order violates the correlative rights of the producers.

8. The contention that the Commission's order of

February 16, 1983, changing the provisions of Paragraph (P) of the Hugoton basic order invades the exclusive jurisdiction of the FERC under the Natural Gas Act is without merit. The Hugoton basic order Paragraph (P) as amended is a gas conservation order prescribing field rules for the producers of gas from the field. The February 16 order is directed to and affects only those who drill for and produce gas from the Hugoton Field. The purpose of the basic order is to prevent waste, protect the correlative rights of mineral interests owners and promote the orderly development of the field, functions clearly reserved to the states under the production exemption of the Natural Gas Act. The February 16th order does not require pipelines purchasers to do anything or refrain from doing anything. The order permits the reinstatement of cancelled underages and the production of the underages reinstated if applications are timely filed and the gas timely produced. The obligations imposed to file applications for reinstatement of cancelled underages is on the producers, not the purchasers. The instant order is clearly distinguishable from the order considered by the United States Supreme Court in *Northern Natural Gas Company v. State Corporation Commission,* 372 U.S. 84 (1962).

9. The authority of this Commission under K.S.A. 1982 Supp. 55-703 relating to the reinstating of cancelled underages has been previously challenged and determined by the Kansas Supreme Court. The Court in the *Republic Natural Gas Company v. State Corporation Commission,* 173 Kan. 172 (1953), affirmed this Commission's actions in refusing to reinstate underages cancelled pursuant to Paragraph (P) of the basic proration. The underages which the court said the Commission was correct in not reinstating in the *Republic* case, were underages that were in excess of three times a well's

current allowable. The Commission, in its order of February 16, permits applications to be filed requesting reinstatement of underages in excess of six times the current January allowable. The order permits these applications to be filed until December 31, 1983, for underages cancelled prior to January 1, 1975; until December 3, 1985, for underages cancelled between January 1, 1975 and December 31, 1982; and a full three years for underages cancelled after December 31, 1982. Surely, if the Commission has authority under the statute to refuse to reinstate cancelled underages as the Court found in the *Republic* case, the Commission has the authority to limit the time within which applications must be filed and underages reinstated must be produced.

10. Some of the applicants for rehearing contend that the February 16 order is unreasonable because it disregarded the weight of the evidence in relying on Staff's evidence and testimony. This allegation completely disregards the fact that the Commission did not adopt the Staff's recommendations. The Commission made specific findings of fact based on the record. The Commission's order is predicated upon a review of all the testimony in the record and therefore reasonable and proper.

11. The Commission does not interpret the provisions of 55-703 as limiting the Commission's jurisdiction to placing restrictions upon the amount of gas to be produced from a common reservoir. The determination of the market demand from the Hugoton Field and the assignment of permissive allowables permitting the production of that market demand is only part of the Commission's obligations under the conservation statute. The prescribing of reasonable periods of time in which those allowables must be produced is as important as

the assignment of the allowables in the first instance. As the Supreme Court stated in the *Republic* case, "By the very nature of the business of conserving the gas supply, the time element must be considered." The legislature recognized this when it provided: "Then any person, firm or corporation having the right to produce natural gas therefrom, may produce only such portion of all the natural gas that may be currently produced without waste and to satisfy the market demands, —." 'Currently' as used in the above, logically refers to some period of time. The Commission has the authority to make a determination as to what reasonable time limitations should be implemented in the field. The Commission's order of February 16 does set forth reasonable time limitations for the reinstatement and production of cancelled underage from the field in keeping with its authority.

12. The contention of certain producers that the order of February 16 will violate their correlative rights is predicated. Upon the fact that allowables once assigned, if not ultimately permitted to be produced, prevents that producer from producing approximately the amount of gas underlying its lease. This argument overlooks the fact that allowables are permissive not mandatory by nature. The Commission cannot make a producer produce its current allowable. The Commission must, and has according to the record, assigned allowables to the various wells in the field that will permit them, if produced, to recover approximately the amount of gas underlying their lease. The obligation on the Commission to assign allowables and regulate the production of gas in a manner that will ultimately let each producer recover approximately the amount of gas underlying the lease must be balanced with the obligation of the Commission to permit each producer to produce only such portion of all the natural gas that may

be currently produced without waste and that will satisfy the market demands. As the Supreme Court of Kansas stated in the *Republic* case, "The market in which the producer has the right to participate is a 'given market.' It is the current market upon which each month's allowable is based. The Commission's order will not cause the violation of correlative rights.

13. The contention is made by certain parties requesting modifications in the Commission's February 16 order, that the order could ultimately cause waste of the natural gas by requiring the reinstated underages to be produced at a rate that could cause damage to the reservoir. This concern, of course, could be alleviated by determination by the Commission that cancelled underages should not be permitted to be produced and once cancelled be permanently cancelled. The Commission, however, does not find that the allegations that the reinstatement order would cause waste justify altering its original order in this proceeding. The testimony of Mr. Wilkonson in this regard was speculative and was predicated upon the Commission's adopting the time restraints recommended by the Staff. As previously stated, the Commission did not adopt the Staff recommendations. The most limiting restraint placed upon the reinstatement and production of cancelled underages relates to underages cancelled prior to January 1, 1975. Applications must be filed by December 31, 1983, and the time for which these underages may be produced is discretionary with the Commission, but a period not in excess of five years. The record does not indicate the volume of gas that is subject to reinstatement under this provision in the order, but with the volume of gas not known, it is purely speculative that the production of such volumes in addition to the current allowables to be fixed by the Commission during the ensuing period

could cause physical damage to the reservoir. The allowables cancelled after January 1, 1975, and cancelled in the future will have approximately three years before applications for reinstatement have to be filed and another five years in which those underages can be produced. There is no evidence in the record that would indicate the reinstatement and production of underages over this period of time would in any way damage the wells or the reservoir.

14. It is argued that the Commission's February 16th order constitutes retroactive rule making. It is difficult to understand the basis for this argument. It has been pointed out numerous times that this Commission has amended various provisions of the Hugoton basic order, including Paragraph (P) to meet the changing conditions in the field. Such changes have been upheld by the courts as being within the Commission's authority. In issuing the February 16th order, the Commission is once again making amendments to its order to address the current situation in the field. Such action by the Commission was and continues to be proper.

15. The Commission's order of February 16, is in accordance with its statutory mandates and does not invade the jurisdiction of the FERC. The order is based on substantial competent evidence and is therefore reasonable and proper.

It is, therefore, by the Commission ordered that its order of February 16, 1983, with the exception of Paragraph (11) be and the same is hereby affirmed.

The Provisions of Paragraph (11) are hereby modified as set forth in finding (6) above.

The Commission retains jurisdiction over the subject matter and the parties for the purpose of entering

such further order or orders as from time to time it may deep proper.

Loux, Chmn.; Roy, Com.; Dick, Com.

Dated April 18, 1983

Judith McConnell
Executive Secretary

APPENDIX E

#83C20

SUPREME COURT,
STATE OF KANSAS, } ss. Dist. Court No. 83C20, 21, 22, 23, 24 No. 84-56917-S

The State of Kansas, to the District Court within and for the County of Gray in the State of Kansas, Greeting:

WHEREAS, In a certain civil, ~~criminal~~ action lately pending before you, wherein

Northern Natural Gas Company, et al plaintiffs

and

The State Corporation Commission, et al defendants

a judgment was rendered by you against the said Plaintiffs

from which judgment said Plaintiffs

prosecuted an appeal in the Supreme Court within and for the State of Kansas;

AND WHEREAS, at the February Session of the January Term of said Supreme Court, A. D. 19 85, on consideration of the said appeal it was ordered and adjudged by the said Supreme Court that the judgment of the District Court be Affirmed, attested true copy opinion attached

and that the said recover against the said Dollars for costs herein expended and have execution therefor.

YOU ARE THEREFORE COMMANDED, That without delay you cause execution to be had of the said judgment of the Supreme Court, according to law.

1985 JUN 10 PM 1:55

Costs

Fees of Clerk Supreme Court $ Paid

Record

Transcript

Other costs

Total $

WITNESS my hand and the seal of said Supreme Court affixed hereto, at my office, in the City of Topeka, on the JUN 7 - 1985 day of A. D. 19

Lewis C Carter

LEWIS C. CARTER, *Clerk of the Supreme Court.*

MANDATE RECEIVED BY CLERK
TRIAL JUDGE NOTIFIED Date:

No._____

vs.

Mandate from Supreme Court

STATE OF KANSAS, _____ County, } ss.

Received and filed _____ 19____

Clerk of District Court.

Deputy.

1995 JUN 10 PM 1:57

APPENDIX F

IN THE SUPREME COURT OF THE STATE OF KANSAS

No. 56,917

NORTHWEST CENTRAL PIPELINE CORPORATION, et al.,
Appellants,

vs.

THE STATE CORPORATION COMMISSION OF THE STATE OF KANSAS, et. al.,
Apellees.

NOTICE OF APPEAL TO THE SUPREME COURT OF THE UNITED STATES

Notice is hereby given that Northwest Central Pipeline Corporation and K N Energy, Inc., appellants in the above styled cause, hereby appeal to the Supreme Court of the United States from the Order and Judgment of this Court, entered May 8, 1985, which found that Order No. C-164 of the State Corporation Commission of the State of Kansas, amending paragraph (p) of the proration order for the Hugoton field, was not repugnant to the Supremacy Clause, Commerce Clause, and Fourteenth Amendment of the Constitution of the United States.

This appeal is taken pursuant to 28 U.S.C. § 1257(2). This 24th day of July, 1985.

NORTHWEST CENTRAL PIPELINE
CORPORATION and K N ENERGY, INC.
By Kent L. Jones
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William J. Sears
John H. Cary
NORTHWEST CENTRAL PIPELINE CORPORATION

William F. Garner, Jr.
K N ENERGY, INC.

ATTORNEYS FOR APPELLANTS

CERTIFICATE OF SERVICE

I hereby certify that five (5) copies of the above and foregoing Notice of Appeal to the Supreme Court of the United States were mailed, postage prepaid, this 24th day of July, 1985, addressed to the following:

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Assistant General Counsel
Kansas Corporation Commission
Conservation Division
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Kent L. Jones

APPENDIX G

FEDERAL CONSTITUTIONAL AND STATUTORY PROVISIONS

The Commerce Clause of the Constitution, U.S. Const. art. I, § 8, cl. 3:

> The Congress shall have power . . . to regulate commerce with foreign Nations, and among the several states, and with the Indian Tribes . . . .

The Supremacy Clause of the Constitution, U.S. Const. art. VI, cl. 2:

> SUPREME LAW OF LAND
>
> This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

Section 1 (b) of the Natural Gas Act, 15 U.S.C. § 717 (b):

> (b) The provisions of this chapter shall apply to the transportation of natural gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other use, and to natural gas companies engaged in such transportation for sale, but shall not apply to any other transportation or sale of natural gas or to the local distribution of natural gas or to the facilities used for such distribution or to the production or gathering of natural gas.

Section 601 of the Natural Gas Policy Act of 1978 (NGPA), 15 U.S.C. § 3431:

COORDINATION WITH NATURAL GAS ACT

(a) Jurisdiction of Commission under Natural Gas Act. —

(1) Sales. —

(A) *Natural gas not committed or dedicated.* — For purposes of section 1(b) of the Natural Gas Act, effective on the first day of the first month beginning after November 9, 1978, the provisions of the Natural Gas Act and the jurisdiction of the Commission under such Act shall not apply to natural gas which was not committed or dedicated to interstate commerce as of November 8, 1978, solely by reason of any first sale of such natural gas.

(B) *Committed or dedicated natural gas.* — Effective beginning on the first day of the first month beginning after November 9, 1978, for purposes of section 1(b) of the Natural Gas Act, the provisions of such Act and the jurisdiction of the Commission under such Act shall not apply solely by reason of any first sale of natural gas which is committed or dedicated to interstate commerce as of November 8, 1978, and which is —

(i) high-cost natural gas (as defined in section 3317 (c), (1), (2), (3), or (4) of this title);

(ii) new natural gas (as defined in section 3312 (c) of this title); or

(iii) natural gas produced from any new, onshore production well (as defined in section 3313 (c) of this title).

(C) *Authorized sales or assignments.* — For purposes of section 1 (b) of the Natural Gas

Act, the provisions of the Natural Gas Act and the jurisdiction of the Commission under such Act shall not apply by reason of any sale of natural gas —

(i) authorized under section 3362 (a) or 3371 (b) of this title; or

(ii) pursuant to any assigned authorized under section 3371 (a) of this title.

(D) *Natural-gas company.* —
For purposes of the Natural Gas Act, the term "natural-gas company" (as defined in section 2 (6) of such Act) shall not include any person by reason of, or with respect to, any sale of natural gas if the provisions of the Natural Gas Act and the jurisdiction of the Commission do not apply to such sale solely by reason of subparagraph (A), (B), or (C) of this paragraph.

(E) *Alaskan natural gas.* —
Subparagraph (B) (ii) and (iii) shall not apply with respect to natural gas produced from the Prudhoe Bay unit of Alaska and transported through the transportation system approved under the Alaska Natural Gas Transportation Act of 1976.

(2) Transportation. —

(A) *Jursidiction of the Commission.*
For purposes of section 1 (b) of the Natural Gas Act the provisions of such Act and the jurisdiction of the Commission under such Act shall not apply to any transportation in interstate commerce of natural gas if such transportation is —

(i) pursuant to any order under section 3362 (c) or section 3363 (b), (c), (d), or (h) of this title; or

(ii) authorized by the Commission under section 3371 (a) of this title.

(B) *Natural-gas company.*
For purposes of the Natural Gas Act, the term "natural-gas company" (as defined in section 2 (6) of such Act) shall not include any person by reason of, or with respect to, any transportation of natural gas if the provisions of the Natural Gas Act and the jurisdiction of the Commission under the Natural Gas Act do not apply to such transportation by reason of subparagraph (A) of this paragraph.

(b) Charges deemed just and reasonable.

(1) Sales.

(A) *First sales.* Subject to paragraph (4), for purposes of sections 4 and 5 of the Natural Gas Act, any amountg paid in any first sale of natural gas shall be deemed to be just and reasonable if —

(i) such amount does not exceed the applicable maximum lawful price established under sub-chapter I of this chapter; or

(ii) there is no applicable maximum lawful price solely by reason of the elimination of price controls pursuant to part B of subchapter I of this chapter.

(B) *Emergency sales.* For purposes of sections 4 and 5 of the Natural Gas Act, any amount paid in any sale authorized under section 3361 (a) of this title shall be deemed to be just and reasonable if such amount does not exceed the fair and equitable price established under such section and applicable to such sale.

(C) *Sales by intrastate pipelines.* For purposes of sections 4 and 5 of the Natural Gas Act, any amount paid in any sale authorized by the Commission under section 3371 (b) of this title shall be deemed to be just and reasonable if such amount does not exceed the fair and equitable price established by the Commission and applicable to such sale.

(D) *Assignments.* For purposes of sections 4 and 5 of the Natural Gas Act, any amount paid pursuant to the terms of any contract with respect to that portion of which the Commission was authorized an assignment authorized under section 3372 (a) of this title shall be deemed to be just amd reasonable if such amount does not exceed the applicable maximum lawful price established under subchapter I of this chapter.

(E) *Affiliated entitles limitation.* For purposes of paragraph (a), in the case of any first sale between any interstate pipeline and any affiliate of such pipeline, any amount paid in any first sale shall be deemed to be just and reasonable if, in addition to satisfying the requirements of such paragraph, such amount does not exceed the amount paid in comparable first sales between persons not affiliated with such interstate pipeline.

(2) Other charges. —

(A) *Allocation.* — For purposes of sections 4 and 5 of the Natural Gas Act, any amount paid by any interstate pipeline for transportation, storage, delivery or other services provided pursuant to any order under section 3363 (b), (c), or (d) of this title shall be deemed to be just and reasonable if such amount is prescribed by the

President under Section 3363 (h) (1) of this title.

(B) *Transportation.* — For purposes of sections 4 and 5 of the Natural Gas Act, any amount paid by any interstate pipeline for any transportation authorized by the Commission under section 3371 (a) of this title shall be deemed to be just and reasonable if such amount does not exceed that approved by the Commission under such section.

(c) Guaranteed passthrough.

(1) *Certificate may not be denied based upon price.* — The Commission may not deny, or condition the grant of, any certificate under section 7 of the Natural Gas Act based upon the amount paid in any sale of natural gas, if such amount is deemed to be just and reasonable under subsection (b) of this section.

(2) *Recovery of just and reasonable prices paid.* — For purposes of sections 4 and 5 of the Natural Gas Act, the Commission may not deny any interstate pipeline recovery of any amount paid with respect to any purchase of natural gas if —

(A) under subsection (b) of this section, such amount is deemed to be just and reasonable for purposes of sections 4 and 5 of such Act, and

(B) such recovery is not inconsistent with any requirement of any rule under section 3341 of this title (including any amendment under section 3342 of this title),

except to the extent the Commission determines that the amount paid was excessive due to fraud, abuse, or similar grounds.

Section 602 of the NGPA, 15 U.S.C. § 3432:

EFFECT ON STATE LAWS

(a) *Authority to prescribe lower maximum lawful prices.* — Nothing in this chapter shall affect the authority of any State to establish or enforce any maximum lawful price for the first sale of natural gas produced in such State which does not exceed the applicable maximum lawful price, if any, under subchapter I of this chapter.

(b) *Common carriers.* — No person shall be subject to regulation as a common carrier under any provision of Federal or State law by reason of any transportation —

(1) pursuant to any order under section 3362 (c) or section 3363 (b), (c), (d), or (i) of this title; or

(2) authorized by the Commission under section 3371 (a) of this title.

APPENDIX H

STATE STATUTES AND REGULATIONS

Kansas Statutes

K.S.A. 55-601. *Waste Prohibited.* The production of crude oil or petroleum in the state of Kansas in such manner and under such conditions as to constitute waste is hereby prohibited and shall be unlawful.

K.S.A. 55-602. *Waste defined; rules and regulations; person defined.* The term "waste" as used herein, in addition to its ordinary meaning, shall include economic waste, underground waste, surface waste, waste of reservoir energy, and the production of crude oil or petroleum in excess of transportation or marketing facilities or reasonable market demands. The state corporation commission shall have authority to make rules and regulations for the prevention of such waste and for the protection of all fresh-water strata, and oil-and gas-bearing strata encountered in any well drilled for, or producing, oil. "Person" as herein used shall mean any natural person, corporation, association, partnership, receiver, trustee, guardian, executor, administrator and a fiduciary of any kind.

K.S.A. 55-603. *Production regulated; temporary bonus or discovery allowables to wells in new oil common sources of supply; prevention of unreasonable discrimination.* Whenever the full production from any common source of supply, herein called "pool" of crude oil in this state can only be obtained under conditions (a) constituting waste as herein defined, or (b) independently of waste, under conditions injurious to the respective correlative rights of the producers therein, or (c) under conditions unreasonably discriminating against other pools in the

state, then any person having the right to drill into and produce oil therefrom may take therefrom currently no more than that proportion of all crude oil which may be produced therefrom, currently without waste, or without such injury, or without such discrimination, which the productivity of his or her well or wells considered in connection with the acreage reasonably attributable to each thereof bears to the productivity of all the wells therein considered in connection with the acreage reasonably attributable to each thereof: *Provided, however,* That the commission may after notice and hearing, grant a temporary bonus or discovery allowables, in addition to normal allowables, to oil wells which are completed in and which produce from any new and separate oil common source of supply, as determined by the commission. Any temporary bonus or discovery allowable so granted may be modified, reduced or discontinued by the commission at any time after due notice has been given to all interested parties. The state corporation commission is authorized and it shall be its duty, to so regulate the taking of crude oil from any pool within the state of Kansas as to prevent waste therein or, independently of waste, to prevent unreasonable discrimination therein; and said commission is further authorized, and it shall be its duty, to prevent unreasonable discrimination in favor of any one pool as against any other pool or pools in this state in the allocation of allowable production among such pools.

K.S.A. 55-604. *Rules and regulations; agents; powers of commission; acreage adjustment, when.*

(A) The commission shall have and is hereby given jurisdiction and authority over all matters involving the application and enforcement of this act,

and shall have authority to make and enforce rules, regulations and orders for the prevention of waste as herein defined and for carrying out and enforcing each and all of the provisions of this act; and the commission shall have authority to make and enforce rules, regulations and orders which provide for the granting of temporary bonus or discovery allowables, in addition to normal allowables, to oil wells which are completed in and which produce from any new and separate oil common source of supply as determined by the commission and which provide for the modification, reduction or discontinuance of such temporary bonus or discovery allowables at any time, and it is authorized to employ or appoint such agent or agents as may be necessary to enforce and administer the provisions of this act, and its rules, regulations and orders; such agent or agents, with the exception of clerical help, to be a person or persons experienced in and conversant with the oil business; and, without limiting the generality of the foregoing powers and duties, the commission shall have the further power and authority hereinafter set forth.

(B) The commission shall determine the reasonable market demand for crude oil produced in this state and shall allocate among the pools in the state the amount of oil that may be produced therein without waste, impairment of correlative rights and unreasonable discrimination between pools. In making such determinations of the reasonable market demand the commission shall take into consideration, among other proper factors, and give due and proper weight to the following:

(a) The estimated consumer demand;

(b) offers to purchase and the good faith thereof;

(c) the price or prices offered in relation to the prevailing price of crude oil generally in the state: *Provided,* That nothing contained in this section is intended to vest the commission with authority to fix the price of crude oil but such limitation shall not affect the authority of the commission prescribed under K.S.A. 55-612; and in making such allocation among the pools in the state the commission shall take into consideration, among other proper factors, and give due and proper weight to the following:

(d) The prevention of waste in any pool;

(e) the quantity of oil that will be produced from nonprorated pools;

(f) the ratio of the daily productive capacity of each prorated pool to the total daily productive capacity of all prorated pools in the state, after the commission shall have adjusted the said respective daily productive capacities of such pools by such method as the commission may find necessary so that the ratio when so adjusted and applied will result approximately in a fair and equitable allocation of the production among such pools, and as a basis for such adjustment of ratio, the commission shall make a classification of the prorated pools on the basis of the daily average productive capacities of the wells in such pools respectively, giving due consideration to the acreage reasonably attributable to each well, so that the respective pool classifications, in their order from the smallest to the largest, will be allocated a daily rate of production in percentages on a descending scale, but so as to result in a progressively increasing average daily allowed production in barrels per well from the smallest to the largest

pool classification: *Provided, however,* Such reasonable adjustments may be made with respect to any pool or pools as the commission may find to be necessary under the practical circumstances:

(g) the availability of pipelines and other means of transportation;

(h) the reasonable ability of each purchaser to satisfy his or her or its desire for oil produced in this state without concentrating purchases in any selected pool or pools, and the availability of oil to the various purchasers by exchange with or purchase from other purchasers of oil produced in this state;

(i) the quantity of oil which is produced from wells which have been granted temporary bonus or discovery allowables; all to the end that so far as possible no producer or group of producers and no purchaser or group of purchasers shall have or be given any special favor or privilege, that the development and conservation of the oil resources of this state may be encouraged, and that the general welfare and prosperity of oil producers, royalty owners and the general public in this state may be promoted. Such determination and allocation shall be made from time to time as circumstances may require.

(C) In prorating the production allowed to each pool among the wells therein, the commission shall take into consideration, among such other factors as it may find proper, and give due and proper weight to:

(a) The productivity of each such well as determined by such reasonable method as the commission shall adopt for the pool;

(b) the acreage of each well owner which is reasonably attributable to each of the owner's wells; and

(c) the efficient utilization of the reservoir energy in the pool: *Provided,* That the allowable production of any well in any prorated pool shall not be reduced below twenty-five (25) barrels per day: *Provided further,* That the twenty-five (25) barrels per day minimum per well allowable may be reduced proportionately when the acreage attributable to any well is less than the number of acres in a spacing unit established by the corporation commission for wells in a spaced pool. In the absence of such a spacing unit, when the acreage attributable to any well is less than ten (10) acres, the twenty-five (25) barrels per day minimum per well allowable may be reduced in the proportion that the acreage attributable to the well bears to ten (10) acres: *Provided further,* That the reduction in the twenty-five (25) barrels per day minimum per well allowable by virtue of acreage adjustment shall not apply to oil and gas wells drilled or commenced prior to the effective date of this act.

(D) When it shall appear to the commission that those having a right to drill into and produce oil from any pool, part of any pool, or prospective pool, in this state, have unanimously agreed upon a plan for the development of said pool, part of any pool or prospective pool or for the distribution of allowed production therein, then the commission, after notice and hearing, may approve such plan and/or distribution.

K.S.A. 55-701. *Waste of natural gas prohibited.* The production of natural gas in the state of Kansas in

such manner and under such conditions and for such purposes as to constitute waste is hereby prohibited.

K.S.A. 55-702. *Definitions.* The term "waste", in addition to its ordinary meaning, shall include economic waste, underground waste and surface waste. Economic waste shall mean the use of natural gas in any manner or process except for efficient light, fuel, carbon black manufacturing and repressuring, or for chemical or other processes by which such gas is efficiently converted into a solid or a liquid substance. The term waste shall not include the use or flaring of natural gas if permitted pursuant to an order issued or rule and regulation adopted under the provisions of subsection (b) of K.S.A. 55-102, and amendments thereto. The term "common source of supply" shall include that portion lying within this state of any gas reservoir lying partly within and partly without this state. The term "commission" shall mean the state corporation commission of the state of Kansas, its successors, or such other commission or board as may hereafter be vested with jurisdiction over the subject matter of this act.

K.S.A. 55-703. *Regulation of production of natural gas by commission; considerations in determination of production from common sources of supply.* Whenever the available production of natural gas from any common source of supply is in excess of the market demands for natural gas from the common source of supply, or whenever the market demands for natural gas from any common source of supply can be fulfilled only by the production of natural gas from the common source of supply under conditions constituting waste, or whenever

the commission finds and determines that the orderly development of and production of natural gas from any common source of supply requires the exercise of its jurisdiction, then any person, firm or corporation having the right to produce natural gas from the common source of supply may produce only that portion of all the natural gas that may be currently produced without waste and to satisfy the market demands, as will permit each developed lease to ultimately produce approximately the amount of gas underlying the developed lease and currently produce proportionately with other developed leases in the common source of supply without uncompensated cognizable drainage between separately-owned, developed leases or parts thereof.

The commission shall regulate the taking of natural gas from any and all common sources of supply within this state in order to prevent the inequitable or unfair taking of natural gas from a common source of supply by any person, firm or corporation and to prevent unreasonable discrimination in favor of any one common source of supply as against another and in favor of or against any producer in any common source of supply. In promulgating rules, regulations and formulas, to attain such results the commission shall give equitable consideration to acreage, pressure, open flow, porosity, permeability and thickness of pay, and such other factors, conditions and circumstances as may exist in the common source of supply under consideration at the time, as may be pertinent.

The commission in determining the market demand for gas from a common source of supply shall consider the reasonable current requirements for

current consumption and use within and without the state, and such other factors, conditions, or circumstances that would aid in establishing the market demand.

K.S.A. 55-703a. *Well spacing and orderly development.* The drilling and completion of a gas well shall not of itself entitle said well to an allowable for production; and the commission may, in its discretion, provide for well spacing in any such common source of supply and provide for the orderly development thereof.

K.S.A. 55-704. *Rules and regulations authorized; notice and hearings.* The commission shall promulgate such rules and regulations as may be necessary for the prevention of waste as defined by this act, the protection of all water, oil or gas-bearing strata encountered in any well drilled in such common source of supply, ascertaining the several factors entering into the determination of the productive capacity of each well, the total productive capacity of all wells in the common source of supply, the establishment of such other standard or standards as the commission may find proper to determine the productive capacity of each well and of all wells in such common source of supply, and as the commission may find necessary and proper to carry out the spirit and purpose of this act: *Provided, however,* That notice, as provided in K.S.A. 55-706, shall be served upon or given to the producers and purchasers of natural gas and all other persons, firms or corporations interested, of any hearing or hearings which may be called for the purpose of establishing any facts upon which any proposed rule or regulation may be based.

K.S.A. 55-705a. *Certificate required; notice and*

hearing. Before any gas shall be produced from a well producing gas only, or from a well which is primarily a gas well, for any of the purposes specified in K.S.A. 55-702, a certificate shall be obtained from the commission for the construction of the facilities necessary or required and/or the utilization of the gas in the manner and for the purposes intended; and the commission shall issue such certificate unless it finds, upon application and after hearing, that the contemplated production or use of such gas is in violation of this act: *Provided, however,* That no such certificate shall be required on account of such facilities as were in existence or under construction, or such uses as were being made of such gas, on February 1, 1945.

Kansas Administrative Regulations

K.A.R. 82-3-101. *Definitions.* (a) As used in these regulations: (1) "Acreage factor" means the quotient obtained by dividing the acreage attributable to a well by the basic acreage unit. The basic acreage unit shall be defined by the commission and promulgated in the basic proration order for the common source of supply in which the well is located.

(2) "Allowable" means the amount of oil or gas authorized to be produced by order of the commission.

(3) "Allowable period" means the time in which the allowable may be produced.

(4) "Assessment" means any charge against the parties involved in any hearing, application, investigation, or the enforcement of an order, and the assessment on natural gas and oil produced to pay the costs associated with the administration of the oil or gas conservation act.

(5) "Attributable acreage" means the acreage

assigned to a well in accordance with the well spacing program adopted for each of the prorated fields.

(6) "Casing" means tubular goods used to line a well bore.

(7) "Casing-head gas" means gas produced that was in solution with oil in its original state in the reservoir.

(8) "Cement" means Portland cement or a blend of Portland cement used in the oil and gas industry to support and protect casing and to prevent the migration of subsurface fluids by the formation of an impermeable barrier.

(9) "Combination well" means a well productive of both oil and gas, excluding casing-head gas, from the same common source of supply.

(10) "Commingling" means the mixing of production from more than one common source of supply.

(11) "Commission" means the state corporation commission.

(12) "Common source of supply" means each geographic area or horizon definitely separated from any other area or horizon which contains, or appears to contain, a common accumulation of oil or gas or both.

(13) "Conservation division" means the division of the commission in charge of the administration of the oil and gas conservation acts, well plugging, salt water disposal, and enhanced recovery.

(14) "Correlative rights" means that each owner or producer in a common source of supply is privileged to produce from that supply only in a manner or amount that will not injure the reservoir to the detriment of others, take an undue proportion of the obtainable oil or gas, or cause undue drainage between developed leases.

(15) "Day" means a period of 24 consecutive hours.

(16) "Deliverability" means the amount of natural gas, expressed in m.c.f. per day, which a well is capable of producing into a pipeline, while maintaining a back-pressure against the well head. The amount of back-pressure to be maintained and the test procedure shall be specified by the commission in the basic proration order for the common source of supply in which the well is located.

(17) "Discovery well" means the first well completed in a common source of supply which is not in communication with any other common source of supply.

(18) "Disposal well" means a well which injects, for purposes other than enhanced recovery, those fluids brought to the surface in connection with oil and natural gas production.

(19) "Division order" means a dated written statement, duly signed by the owners and delivered to the purchasers, certifying and guaranteeing the interests of ownership of production, and directing payment according to those interests.

(20) "Enhanced recovery" means any process involving the injection of fluids into a pool to increase the recovery of oil or gas.

(21) "Enhanced recovery injection well" means a well which injects fluids to increase the recovery of hydrocarbons.

(22) "Field" means a geographic area containing one or more pools.

(23) "First purchaser" means the person holding the division order and issuing checks to pay any working or royalty interest.

(24) "Fluid" means a material or substance which flows or moves in a semi-solid, liquid, sludge, or gas state.

(25) "Gas" means the gas obtained from gas or

combination wells regardless of its chemical analysis.

(26) "Gas" (cubic foot) means the volume of gas contained in one cubic foot of space at a standard pressure base and at a standard temperature base. The standard pressure base shall be 14.65 pounds per square inch absolute, and the standard temperature base shall be 60 degrees Fahrenheit. Whenever the conditions of pressure and temperature differ from the above standard, conversion of the volume from these conditions to the standard conditions shall be made in accordance with the ideal gas laws as corrected for deviation.

(27) "Gas-oil ratio" means the ratio of gas produced in cubic feet to one barrel of oil produced during the concurrent period.

(28) "Gas" (sour) means any natural gas containing more than 1 grains of hydrogen sulphide per 100 cubic feet or more than 30 grains of total sulphur per 100 cubic feet, or gas which in its natural state is found by the commission to be unfit for use in generating electricity or fuel for domestic purposes.

(29) "Illegal production" means any production in violation of the statutes, rules, regulations or orders of the commission.

(30) "Minimum well" means any oil well which has a productivity of 25 barrels or less per day.

(31) "Mousehole" means a service hole drilled at a slight angle and normally about 30 feet deep on those wells drilled by rotary tools.

(32) "Mud-laden fluid" means any commission approved mixture of water and clay or other material, as the term is commonly used in the industry, which will effectively seal a formation to which it is applied.

(33) "Oil" means crude oil or petroleum and shall

include all waste oil which is removed from the lease.

(34) "Oil, (pipeline)" means oil free from water and basic sediment to the degree that it is acceptable for pipeline transportation and refinery use.

(35) "Oil well" means any well producing oil.

(36) "Open flow" means the volume of gas which a gas well is capable of producing at the wellhead during a period of 24 hours against atmospheric pressure, computed according to the standard procedure approved by the commission.

(37) "Operator" means any person who is in charge of the development of a lease, or the operation of a producing well.

(38) "Overage" or "overproduction" means the oil or gas produced in excess of the allowable.

(39) "Person" means any natural person, corporation, association, partnership, governmental or political subdivision, receiver, trustee, guardian, executor, administrator, fiduciary, or any other legal entity.

(40) "Pipeline" means any pipes above or below the ground used or to be used for the transportation of oil, gas liquids, or gases.

(41) "Pool" means a common source of supply as officially named.

(42) "Producer" means any person who owns, in whole or in part, a well capable of producing oil or gas or both.

(43) "Production" means produced oil, gas, condensate, or casing-head gas.

(44) "Productivity of a well" means the daily capacity of a well to produce oil or gas.

(45) "Productivity of a pool" means the sum of the productivities of the wells completed in the pool.

(46) "Proration" means the regulation of the amount of allowed production to prevent waste, un-

due drainage between developed leases, unratable taking, or unreasonable discrimination between operators, producers and royalty owners who are within a common source of supply, that would favor any one pool as compared to any other pool in this state.

(47) "Purchaser" means any person who purchases production from a well, lease or common source of supply.

(48) "Rathole" means the service hole drilled at a slight angle and normally about 40 feet deep on those wells drilled by rotary tools.

(49) "Reasonable market demand" means the amount of crude petroleum or natural gas which must be produced to satisfy current rates of consumption.

(50) "Service well" means a well drilled for:

(A) The injection of fluids in enhanced recovery projects; or

(B) The supply of fluids for enhanced recovery projects; or

(C) The disposal of salt water.

(51) "Shortage" means the amount by which the oil or gas legally produced and sold or removed from the premises is less than the allowable.

(52) "Storage oil" means produced oil confined in tanks, reservoirs, or containers.

(53) "Storage oil-lease" means produced oil in tanks, reservoirs, or containers on the lease where it was produced.

(54) "Storage well" means a well used to inject or extract hydrocarbons for storage purposes.

(55) "Stratigraphic hole" means a hole normally of small diameter, drilled through subsurface strata for exploratory purposes, with no intent to produce hydrocarbons through the hole being drilled.

(56) "Undue drainage" means the uncompensated migration of either oil or gas between developed leases within the same common source of supply caused by the unratable production of some well or wells located there.

(57) "Waste oil" means any tank bottom, basic sediment, cut oil, reclaimed oil from pits, ponds or streams, dead oil, emulsions, or other types of oil not defined as pipeline oil.

(58) "Well completion, (oil)" occurs when the first new oil is produced through permanent wellhead equipment into lease tanks from the producing interval after the production casing has been run.

(59) "Well completion, (gas)" occurs when the well is capable of producing gas through permanent wellhead equipment from the producing zone after the production casing has been run.

(60) "Well completion, (dry hole)" occurs when all provisions of plugging are complied with as set out in these regulations.

(61) "Wellhead working pressure" means the static pressure in the annulus while flowing through the tubing or static pressure in the tubing while flowing through the annulus, except in cases where the casing-head is not in open communication with the producing formation because of the presence of a packer or other obstruction in the annular space between casing and tubing. In these cases, the wellhead working pressure shall be determined by adjusting the observed tubing pressure for the effect of friction caused by flow through the tubing, or by using a bottom-hole pressure bomb and correcting back to wellhead conditions.

(62) "Well log" means the written record progressively describing the well's down-hole development.

(63) "Well history" means the chronological record of the development and completion of a well.

(b) All terms not defined in this definitional section shall be interpreted to be consistent with their common use in the industry. (Authorized by and implementing K.S.A. 55-602, 55-604, 55-704, K.S.A. 1982 Supp. 55-152, 55-901; effective, T-83-44, Dec. 8, 1982; effective May 1, 1983).

Paragraphs (1)-(p) of the Basic Proration Order for the Hugoton Gas Field (prior to the 1983 Amendment of paragraph (p)

(1) The determine a well's quota for a given proration period, determine first the proration factor for the field by dividing the total field market demand for such period by the sum of the products of deliverability times the acreage factors of all wells in the pool, then multiply the field proration factor by the product of the deliverability times acreage factor for the well. The result reached by this calculation, as hereinafter adjusted, shall constitute the well's current allowable, in cubic feet, which it may produce for such proration period, provided, that if the current allowable so determined for any well is less than 50 MCF per day, the well shall be assigned a minimum current allowable of 50 MCF times the number of days in the proration period, unless the acreage factor for such well is either more or less than one (1). In that event, the minimum allowable so assigned shall be adjusted by multiplying said minimum allowable times the acreage factor. In order that the allocation to wells within the field may be restricted to the market demand figure determined for the proration period, the proration factor as first determined, shall then be adjusted by computer computation, allowing for

the additional gas necessary for allocation to minimum allowable wells.

Each operator of a well authorized a minimum allowable shall, within 90 days after this order becomes effective, file with the Conservation Division, an affidavit (on a form to be furnished by the Conservation Division upon request) stating that, in the operator's opinion, the well is capable of producing the minimum allowable; the production of the minimum allowable will not be detrimental to the well thereby causing premature abandonment; and the productive capacity of the well cannot be improved by artificial means. Unless such affidavit is filed, the well shall be granted only such allowable as will be assigned by virtue of its adjusted deliverability. Wells which qualify for minimum allowables in the future shall be granted only such allowables as would be assigned by virtue of their adjusted deliverabilities until such time as the affidavits referred to above are filed with the Conservation Division.

(m) That the production of gas in accordance with the above formula has a reasonable relation to prevention of waste, to the prevention of inequitable and unfair production of gas from the common source of supply, and to the prevention of unreasonable discrimination in favor of one producer in said field and against another producer therein and that production of gas in such manner will in fact accomplish the purposes for which article 7, Chapter 55, General Statutes of Kansas for 1935, was enacted. (Kansas Statutes Annotated).

(n) That there shall be held two market demand hearings for each year. The first hearing shall cover the period from October 1st to March 31st, both inclusive, and the second shall cover the period from

April 1st to September 30th, both inclusive. The allowable period established shall be a calendar month. The Commission shall issue its orders covering each allowable period, and such orders shall be issued on, or near, the first day of the month for which such order is issued.

(o) At such time and place as the Commission shall fix, the Commission will, after notice, conduct a hearing to determine the market demand for natural gas from said field for the next six succeeding proration periods, or for such other period of time as the Commission shall prescribe, and at said hearing may determine any other questions which may properly and legally come before the Commission for consideration thereat, and a new schedule of production allowable for the wells in said field, based upon the determination made as a result of such hearing, shall be prepared and promulgated for the ensuing proration periods.

(p) Operators of wells and purchasers or others taking gas from any well, shall endeavor to limit their takes of gas to the quantities fixed in the schedule as the allowable production for such well, provided that if, during the period covered by any schedule, there should develop a substantial increase in the amount of the market demand for gas from said field, the Conservation Division may permit production to be increased ratably from all the wells in the field to meet such emergency increased demand and the facts respecting same shall be reported to the Commission at or before the next periodic market demand hearing for such action thereon as may be proper. If, at the end of any proration period, there is an overage or underage in production for any well during such period, the same shall be carried forward as a charge against or credit

in favor of such well and subtracted from or added to, as the case may be, the allowable for such well for the next proration period. Any well with an adjusted deliverability in excess of 300 MCF may accumulate overproduction equivalent to six times the amount of the current allowable assigned to it for the preceding January before being shut in by the operator or producer and shall not be permitted to produce any gas until such overproduction has been reduced by deductions from such overproduction made by current allowables to the extent that the well shall not be overproduced more than five times the current allowable assigned to it for the preceding January. When any well with an adjusted deliverability in excess of 300 MCF has accumulated underproduction in excess of six times the current allowable assigned to it for the preceding January, such excess shall thereupon be cancelled. Any well with an adjusted deliverability of less than 300 MCF may accumulate overproduction equivalent to nine times the amount of the current allowable assigned to it for the preceding January before being shut in by the operator or producer and shall not be permitted to produce any gas until such overproduction has been reduced by deductions from such overproduction made by current allowables to the extent that the well shall not be overproduced more than eight times the current allowable assigned to it for the preceding January. When any well with an adjusted deliverability of less than 300 MCF has accumulated underproduction in excess of nine times the current allowable assigned to it for the preceding January, such excess shall thereupon be cancelled. Any underage cancelled by the terms of this paragraph shall not be considered in determining the future production

of any such well, unless, upon notice and hearing, the Commission shall otherwise determine. *Provided, however,* that in no event shall any underproduction of an unconnected well be cancelled.

Provided also that underages cancelled under the provisions of this paragraph will be reinstated upon verified application therefore, showing that the wells are in an overproduced status; that the purchaser is willing and able to take the amounts of gas; and that the length of time proposed by applicant for the production of the amounts of gas to be reinstated is reasonable under the circumstances.

Order Dated 11-25-75

The basic allowable (preceding January current allowable) for new wells or wells retested with the approval of the Conservation Division shall be computed by using the same field allowable factor as was used for other wells in the preceding January.

APPENDIX I

The Williams Companies
- Agrico Chemical Company
  - Agrico Canada Limited/Limitee
  - Agrico Chemical Company (Florida)
  - Agrico Chemical of Oklahoma, Inc.
  - Agrico Disc, Inc.
  - Agrico Egypt Limited
  - Agrico Foreign Sales Corporation
  - Agrico, Inc.
  - Agrico Interamericana, S.A.
  - Agrico International Far East, Inc.
  - Agrico International Transportation, S.A.
  - Agrico-Korea Enterprises, S.A.
    - *Namhae Chemical Corporation
  - Agrico Overseas Company, S.A.
    - Agrico Overseas Investment Corporation
      - Agrico Overseas Development Corporation
  - Agrico Shipping Company
  - Agrico Thailand, Inc.
  - Agrico Trinidad, Inc.
- *Colag, Inc.
- *Crop Production Services, Inc.
- Fishhawk Ranch, Inc.
- North Carolina Phosphate Corporation
  - Agrico North Carolina Properties, Inc.
- Northeast Arkansas Transmission Company
- The American Agricultural Chemical Company

*BancOklahoma Corp.
F T & T, Inc.
Faustina Pipe Line Company
Langside Limited
Louisiana Resources Company

NGL Production Company
Northwest Alaska Company
Northwest Energy Company
  Ap Sci, Inc.
  Apco Argentina Inc.
    Apco Properties Ltd.
  Inner Ocean Services Company
  Inner Ocean Services, Inc.
  Northwest Alaskan Pipeline Company
  Northwest Border Pipeline Company
    Northern Border Pipeline Company
      (General Partnership)
  Northwest Canadian Gas Sales Company
  Northwest Carbon Corporation
  Northwest Central Pipeline Corporation
  Northwest Coal Corporation
    Western Slope Carbon, Inc.
  Northwest Field Services Company
  Northwest International Company
    Northwest Argentina Corporation
    Northwest Ecuador Company
    Northwest Guayaquil Company
  Northwest Investments, Incorporated
  Northwest Land Company
  Northwest Overseas Capital Corporation N.V.
    Northwest International Finance B.V.
      Northwest International Finance N.V.
  Northwest Pipeline Corporation
    Phillips Pacific Chemical Company
    Prairie Pipe Lines Limited
    Prairie Transmission Lines Limited
    Trans-Intermountain Gas & Energy Resources
      Company
  Northwest Technical Services Company
  Pacific Northwest Realty Corporation
  SS Properties Incorporated

Northwest Exploration Company
Northwest Canada Exploration Company
Northwest Production Corporation
*Peabody Holding Company, Inc.
Scissortail Natural Gas Company
Tulsa Williams Company
Willco, Inc.
Williams Brothers International Corp.
Williams Exploration Company
Paraffine-Williams Company
Rainbow Resources, Inc.
Williams Drilling Company of Tulsa
Williams Gas Supply Company
Williams Natural Gas Company
Williams Natural Gas Liquids Company
Williams Northwest Corporation
Williams Pipe Line Corporation
WillBros Terminal Company
*Williams Realty Corp.
Atria Hotel, Inc.
Cafes On The Ice, Inc.
1400 Market Street, Inc.
Kennedy Tower, Inc.
Metro Center, Inc.
320 South Boston, Inc.
Tulsa Union Depot, Inc.
Willcentro, Inc.
Williams Center Forum, Inc.
Williams Center, Inc.
Williams Center Plant, Inc.
Williams Center Tower I, Inc.
Williams Center Tower II, Inc.
Williams Plaza Hotel, Inc.
The Barristers Club, Inc.
Williams Real Estate Services, Inc.
Williams Realty Developments, Inc.

WRC of Crown Center, Inc.
Williams Realty Interest, Inc.
Williams Realty of Charlotte, Inc.
Writers Square Condominium, Inc.
WRC of Colorado, Inc.
WRC of Kansas, Inc.
WRC of San Antonio, Inc.
WRC of Texas, Inc.
Williams Telecommunications Company
Williams Terminals Company
Williams Western Pipeline Company

*Companies not consolidated.

The following are all the subsidiaries and affiliates of K N Energy, Inc.:

Western Gas Corporation
K N Alfalfa Corporation
Wyoming Fuel Company
Helium, Inc. (Inactive)
Slurco, Inc.
Slurco Corporation
Northern Utilities, Inc.
Northern Gas Company
Northern Mountain Gas Company
North Central Energy Company
Midlands Transportation Company
Western Oil Corporation
Plains Petroleum Company

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Supreme Court, U.S.
FILED
AUG 30 1985
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CLERK

No. 85-182

In the Supreme Court of the United States

October Term, 1985

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and K N ENERGY, INC.,
Appellants,

vs.

THE STATE CORPORATION COMMISSION OF THE STATE OF KANSAS, et al.,
Appellees.

ON APPEAL FROM THE SUPREME COURT OF KANSAS

MOTION TO AFFIRM OR DISMISS

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QUESTIONS PRESENTED

1. Whether orders issued by the Kansas Corporation Commission amending the Basic Proration Order for the Hugoton Gas Field invade the exclusive jurisdiction of the Federal Energy Regulatory Commission.

2. Whether the orders amending the Basic Proration Order for the Hugoton Gas Field unconstitutionally burden interstate commerce.

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Appellees.

ON APPEAL FROM THE SUPREME COURT OF KANSAS

MOTION TO AFFIRM OR DISMISS

The Appellee moves the Court to dismiss the appeal herein, or, in the alternative, to affirm the judgment of the Supreme Court of the State of Kansas on the ground that the questions upon which the decision of the cause depend are so unsubstantial as to require no further argument.

STATEMENT OF THE CASE

A. Introduction

This appeal questions the authority of the Kansas Corporation Commission (Commission) to enter orders amending the Basic Proration Order for the Hugoton Gas Field.

The orders at issue were directed to producers of gas from this field and set forth how unproduced allowable (underage), which has been cancelled pursuant to the terms of the proration order, may be reinstated and produced.

B. Facts

The Commission accepts the recitation of the facts as set forth in the Appellants' Jurisdictional Statement with the following clarifications.

The Basic Proration Order for the Hugoton Field was issued by the Kansas Commission in 1944 to govern production from this enormous reservoir of gas. At various times the provisions of the Basic Order have been amended to reflect changes in field conditions or market demand. The provision at issue in this appeal, Paragraph (p), has been altered several times to accomodate changes in the field.

Twice each year the Commission considers the projected requirements of the pipelines connected to the field and allocates the demand for gas to the various wells. The objective of the basic order is to give each well the opportunity to produce its underlying reserves through a formula designed to cause a uniform reduction in pressures, consistent with current market demand.

Underages attributed to wells in the field accrue when the wells produce less than their current allowable. The fact that any particular well has accumulated significant underage simply indicates that its allowed production is not being purchased by the connected pipeline. Appellants state that since 1963 "huge" underages have developed as a result of the setting of market demand by the Commission. It must be pointed out that no appeal has been

taken in recent years of any market demand order relating to the Hugoton Field. The last reported case concerned with the Commission's market demand determinations for the Hugoton Field was *Colorado Interstate Gas Co. v. State Corporation Commission,* 192 Kan. 1, 386 P. 2d 266 (1963), *cert. denied,* 379 U.S. 131 (1964).

The Commission in 1982 instituted an investigation of the Basic Order to ascertain if changes should be made because of the amounts of underage which were accumulating to some wells. Paragraph (p) of the Basic Order prescribes the amounts of overproduction which may occur before a well is shut-in, or underproduction which can accumulate before cancellation.

The evidence of all parties at the hearing was in agreement on two points. First, the deliverability formula utilized in the Basic Order is the best method for regulating production from the Hugoton Field. Second, the witnesses agreed that the only solution to the underage problem was increased production from the underproduced wells. There was substantial competent evidence that the situation at that time was causing the violation of correlative rights through the drainage of gas toward wells with higher levels of current production. The disagreement at the hearing centered on how the Commission could best amend Paragraph (p), if at all, to adddress the problems created by large accumulations of underage while pursuing its statutory duty under K.S.A. 55-703 of regulating gas production in an equitable, nonwasteful fashion that will satisfy market demands.

The orders amending Paragraph (p) set forth reasonable time periods under which cancelled underage must be reinstated and produced. When underage attributed to most of the field's wells exceeds six times the January

current allowable, typically the largest monthly allowable, it is cancelled. The producer has three years after the cancellation date to request reinstatement once the well reaches an overproduced status. The reinstated underage must be produced within five years or it is permanently cancelled. The District Court of Gray County, Kansas, and the Kansas Supreme Court, in reviewing these orders, concluded they were lawful and reasonable and affirmed the Commission's actions. These courts noted that the orders were aimed solely at producers and were related to the production and gathering of gas, an area wholly within the province of the state. The permanent cancellation of some unproduced allowable *may* have an effect upon the purchases of connected interstate pipelines. The Commission submits that this indirect effect of the orders at issue is not a substantial federal question that should trigger the jurisdiction of this Court.

ARGUMENTS IN SUPPORT OF MOTION TO DISMISS OR AFFIRM

1. The Amendment to Paragraph (p) Does Not Invade the Exclusive Jurisdiction of the Federal Energy Regulatory Commission.

The Basic Proration Order for the Kansas portion of the Hugoton Field was adopted to regulate the production of gas from this reservoir. This type of state regulation is clearly proper under the Natural Gas Act which exempts from federal jurisdiction "the production or gathering of natural gas." 15 U.S.C. § 717(b). The record developed before the Commission indicated that the correlative rights of producers in this field were being violated by the migration of gas from underproduced wells to wells which were producing their allowables (R. Vol. 9, p. 56). The

administrative record also reflected that Paragraph (p), which then permitted reinstatement of cancelled underage without any time limitations, gave producers no incentive to timely produce their allowables (R. Vol. 9, p. 23). The orders amending Paragraph (p) promulgated time restrictions on the production of gas and were directed solely to producers in the Hugoton Field. Production of gas means the act of bringing gas from the earth and gathering means the act of collecting gas after it has been brought forth. *FPC v. Panhandle Eastern Pipeline Co.*, 337 U.S. 518 (1949). The orders at issue in this appeal lie outside the jurisdiction of the federal government.

The Commission was carrying out traditional state functions over the production of gas when amending Paragraph (p). The production and transportation of gas is a continuous process and regulations regarding the production of gas dedicated to interstate commerce will necessarily impact upon the interstate flow of gas. This Court has long recognized this reality and enunciated when state regulation reaches too far. In *Northern Natural Gas Co. v. State Corporation Commission*, 372 U.S. 84 (1963) it was stated:

> [O]ur cases have consistently recognized a significant distinction, which bears directly upon the constitutional consequences, between conservation measures aimed directly at interstate purchasers and wholesales for resale, and those aimed at producers and production. The former cannot be sustained when they threaten as here, the achievement of the comprehensive scheme of federal regulation. 372 U.S. at 94.

The appellants contend that the orders amending Paragraph (p), although directed at producers, will have an effect on interstate purchasers so broad as to transcend Constitutional limitations. The *Northern Natural* decision

defines when state action is preempted by federal authority. The orders on appeal here are a proper exercise of the state police power when measured by the test of *Northern Natural.*

2. The Amendment to Paragraph (p) Does Not Constitute an Impermissible Burden Upon Interstate Commerce.

As previously discussed in this Motion, the orders amending Paragraph (p) were intended to prevent continued correlative rights violations in the Hugoton Gas Field. The appellants argue that by pursuing this legitimate state concern the Commission was engaging in economic protectionism. The orders at issue were designed to prevent undue drainage to wells through the production of allowables in a more timely fashion. These orders were directed uniformly to all producers in the Hugoton Field and were not intended to favor any particular group of wells, whether dedicated to the interstate or the intrastate market. Evenhanded state regulation to effectuate a legitimate public interest with incidental effects on interstate commerce will be upheld unless the burden imposed is excessive in relation to the putative local benefits. *Arkansas Electric Cooperative Corp. v. Arkansas Public Service Commission,* 461 U.S. 375 (1983). The legitimate public interest is gas production in a manner which protects correlative rights.

Each producer has been assigned allowables in an evenhanded manner, the opportunity of each to produce is the same, and the failure to produce by any or all results in allowable cancellation in a known and equal manner. The alleged burden on interstate commerce, if such an impediment ever comes to pass, will be that the pipeline will not be able to purchase underage that has been per-

manently cancelled. There will be current allowable and presumably, in many cases, accumulated underage that can be purchased from each well to permit the pipeline to meet its obligations. The orders at issue are not violative of the Commerce Clause and do not warrant review by this Court.

3. This Court's Decision in Transcontinental Gas Pipeline Corp. v. State Oil and Gas Board Will Have No Bearing on This Appeal.

The issue of whether a state commission can direct an interstate pipeline to purchase and to ratably take deregulated natural gas from a common source of supply is before this Court in *Transcontinental Gas Pipeline Corporation v. State Oil and Gas Board of Mississippi,* No. 84-1076, *prob. juris. noted,* 85 L. Ed. 2d 140 (March 25, 1985). The *Transco* case involves an administrative order directed to an interstate pipeline. That pipeline, unquestionably subject to the FERC's jurisdiction, contends that the State of Mississippi entered an area preempted by the federal government pursuant to the Natural Gas Act, 15 U.S.C. § 717, *et seq.,* as amended by the Natural Gas Policy Act, 15 U.S.C. § 3301, *et seq.*

Transco, is distinguishable from the instant appeal. The orders amending Paragraph (p) placed no obligation on any interstate pipeline. Those orders were directed at producers and involve entirely different questions than those raised in the *Transco* case. The Kansas Supreme Court noted that under the *Northern Natural* case "the matter of allowables must be construed to pertain to production. The state has regulatory authority over production." (Appellants' Appendix A, 29a). This conclusion is correct, distinguishable from the *Transco* case and should be summarily affirmed by this Court.

CONCLUSION

Appellants' Jurisdictional Statement does not raise a substantial federal question. At issue in this appeal are administrative orders pertaining to the production of natural gas, a traditional state function. These orders do not impinge upon federal authority nor do they create an undue burden on interstate commerce. This appeal should be dismissed and the state court's decision affirmed in all respects.

Respectfully submitted,

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No. 85-182

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October Term, 1985

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Appellants,

vs.

THE STATE CORPORATION COMMISSION OF THE STATE OF KANSAS, et al.,
Appellees.

ON APPEAL FROM THE SUPREME COURT OF KANSAS

BRIEF IN RESPONSE TO THE BRIEF OF THE UNITED STATES AND THE FEDERAL ENERGY REGULATORY COMMISSION AS AMICI CURIAE

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QUESTION PRESENTED

Whether the orders of the Kansas Corporation Commission amending the Basic Proration Order for the Hugoton Gas Field impermissibly interfere with federal regulatory jurisdiction over interstate pipelines.

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At the invitation of the Court, the Solicitor General and the Federal Energy Regulatory Commission filed a brief expressing the views of the United States on the issues raised in this appeal. The Kansas Corporation Commission (Kansas Commission) submits this brief to respond to certain points raised in the Solicitor General's brief.

STATEMENT

This appeal involves orders of the Kansas Commission which altered the way that gas may be produced from the Hugoton Gas Field. The documents previously filed in this cause accurately summarize the way in which underage (unproduced allowable) is cancelled and how this underage must be reinstated and produced within an eight year time period before it is permanently cancelled. The issue before this Court is whether these orders, directed to gas producers, have an indirect effect on interstate pipeline purchasers that impinges upon federal jurisdiction.

ARGUMENT

The brief filed by the Solicitor General addresses two issues that merit further discussion. First, whether the orders of the Kansas Commission impermissibly interfere with the scheme of federal jurisdiction over interstate pipelines. Second, whether this Court's recent decision in the *Transco* case is applicable to the instant appeal. We respectfully submit that the answer to either inquiry is no.

1. The appellants contend that the orders amending the production tolerance provisions of the Basic Proration Order for the Hugoton Gas Field constitute an improper pre-emption of federal authority. Their argument, as properly summarized by the Solicitor General, is that the contract dedication of this gas to the interstate market prevents a state from permanently cancelling any allowable that is not produced within certain time periods (Brief of Amici Curiae at 9). If this argument is correct, then many conservation regulations which direct how gas

may be produced from wells connected to the interstate pipeline system are void.

Prior to the 1983 amendments, cancelled underage could accumulate indefinitely and the pipeline purchasers could postpone taking gas from wells indefinitely without an adverse regulatory effect. At that time there were gas wells in the field which were overproduced and wells which were underproduced and accumulating cancelled underage. Expert testimony presented to the Kansas Commission indicated that this disparity was likely to cause drainage away from the underproduced wells if not remedied. The expert witnesses unanimously agreed that the only true remedy to uncompensated drainage was the production of allowable pursuant to the deliverability formula used to regulate gas production from the Hugoton Field. To effect this remedy, the Kansas Commission tightened the tolerance provisions of the basic proration order to require that underage would be reinstated and produced within eight years after it is cancelled. The appellants complain that this adjustment and its possible effect on their purchasing practices is an impermissible preemption of federal authority.

The Solicitor General quite properly states that the appellants have too narrowly construed the production and gathering exemption of the Natural Gas Act, 15 U.S.C. §717 (b) (Brief of Amici Curiae at 7, footnote 6). The cases cited by the Solicitor General provide that the states' authority under this exemption permits regulations directed at gas producers which further a legitimate conservation concern. See *Thompson v. Consolidated Gas Utilities Corp.*, 300 U.S. 55 (1937). Regulations imposed upon producers which restrict production to a certain percent of a well's open flow, require allowable to be pro-

duced within a given time, or affect the quantity of gas that may be produced in any way inherently have an effect on connected interstate pipelines. These types of regulations, including the orders before this Court, are a proper exercise of state authority over production and gathering.

On December 12th and 13th, 1985, hearings were held by the Kansas Commission to determine whether permanent cancellation of underage scheduled to occur on December 31, 1985, should be delayed. The Kansas Commission ordered that such permanent cancellation be forestalled until September 30, 1987, to give producers additional time to reinstate cancelled underage. The history of the Basic Proration Order for the Hugoton Field has been one of continual adjustments to meet changed circumstances in geological or market conditions. Such changes have an inherent impact upon connected interstate pipelines. The Kansas Commission submits that this indirect effect does not improperly interfere with the federal scheme.

2. The Solicitor General concludes the discussion of this appeal by urging the Court to apply its decision in *Transcontinental Gas Pipe Line Corporation v. State Oil and Gas Board of Mississippi,* No. 84-1076 (filed January 22, 1986), to this case. The Kansas Commission believes the *Transco* case, like *Northern Natural Gas Co. v. State Corporation Commission,* 372 U.S. 84 (1963), is factually distinguishable and inapplicable to this matter. The Solicitor General correctly states that *Transco* and *Northern Natural* involved state action directed at interstate pipelines comprehensively subject to federal regulation (Amici Curiae Brief at 13, footnote 10). The orders at issue in this appeal place no affirmative burden on any interstate

pipeline as was the case in *Transco*. The orders at issue in this appeal do not frustrate the goals of the Natural Gas Policy Act of 1978, 15 U.S.C. §3301, *et seq.*, as summarized by this Court in *Transco*, and fall within the production and gathering exemption of the Natural Gas Act.

The Solicitor General suggests that the record in this appeal lacks findings by the Kansas Commission or state courts as to the effect of the orders on the pipelines and that the case should be remanded for further such findings (Amici Curiae Brief at 12-13). The Kansas Commission submits that the reason for the lack of such findings is that the effect of the rule on the pipelines is not substantial. At the 1982 hearings, no evidence was presented that would suggest that the change would exacerbate the pipelines' take-or-pay problems with producers in other fields or have any adverse effects on their contract relationships, unlike the situations in *Northern* or *Transco*. The Kansas Commission respectfully submits that further hearings on this issue will not produce additional findings that would raise a substantial federal question.

CONCLUSION

The orders of the Kansas Commission were a proper exercise of state authority over the production of natural gas. The decision of the Kansas Supreme Court was correct and should be affirmed by this Court.

Respectfully submitted,

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ON APPEAL FROM THE SUPREME COURT OF KANSAS

BRIEF FOR THE UNITED STATES AND THE FEDERAL ENERGY REGULATORY COMMISSION AS AMICI CURIAE

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QUESTION PRESENTED

Whether the order of the Kansas Corporation Commission regulating the quantity of gas that may be produced from Kansas gas wells impermissibly interferes with the federal regulatory scheme established by the Natural Gas Act, 15 U.S.C. 717, *et seq.*, or exceeds the State's power under the Commerce Clause of the United States Constitution.

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CORPORATION COMMISSION OF KANSAS, ET AL.

ON APPEAL FROM THE SUPREME COURT OF KANSAS

BRIEF FOR THE UNITED STATES AND THE FEDERAL ENERGY REGULATORY COMMISSION AS AMICI CURIAE

This brief is filed in response to the Court's order inviting the Solicitor General to express the views of the United States.

STATEMENT

1. Like other gas producing states, Kansas has laws "to prevent the inequitable or unfair taking of natural gas," Kan. Stat. Ann. § 55-703 (1983) (set forth as J.S. App. 99a-101a). One reason for these laws is that gas can migrate underground, from

underproduced areas of higher pressure to produced areas of lower pressure. Thus, it is theoretically possible to extract from a single well or group of wells all of the recoverable natural gas in the field, exhausting the unproductive or less productive wells (J.S. App. 5a-6a).

With a recent modification we shall describe, the Kansas Corporation Commission (Kansas Commission) has implemented state law since 1944 so that each gas well in the Hugoton Field [1] may "ultimately produce approximately the amount of gas underlying the lease upon which it is located." Basic Proration Order for the Hugoton Gas Field 12-13 (13 R. 37-38). Under these regulations, the Kansas Commission sets "allowables" for the Hugoton field—*i.e.*, gas production ceilings that assign to each producer the maximum amount of gas that may be produced from each well per month.

The rules are thus designed to spread market demand over all producing wells in proportion to their production capability. In practice, however, the wells cannot always meet their monthly allowables—a well may be "shut in" because of mechanical problems or the lack of a willing buyer of the gas, or it may voluntarily under- or overproduce. Consequently, the Kansas scheme uses production tolerances to account for under- or overproduction. If a well produces less than its allowable, it accrues an "underage," measured as the difference between its allowable and its actual production; in the same way, an overproducing well accrues "overages." Both underages and

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[1] The Hugoton field extends across portions of Kansas, Oklahoma and Texas. About two thirds of the field is located in Kansas; that portion of the field contained more than 4,000 wells in 1983 (J.S. 3).

overages can be offset against future allowable levels. For example, a well can exceed its allowable by the amount of its underage if there is a purchaser for the extra gas and the well can physically produce it.

2. In February 1983, the Kansas Commission changed the underage rules to create "an incentive to operators to produce" (J.S. App. 62a).[2] The 1983 change provided, for the first time, that underages would be permanently cancelled if the producer did not reinstate[3] the underage by a certain time or, if reinstated, the underage was not produced within 5 years (J.S. App. 8a-9a). By its express terms, the rule change was "directed to and affects only those who drill for and produce gas from the Hugoton field. * * * [It] does not require pipeline[ ] purchasers to do anything or refrain from doing anything" (J.S. App. 75a).

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[2] For most wells in the Hugoton field, underages had risen dramatically in recent years, reaching over 204 billion cubic feet of gas by 1982 (J. S. App. 62a), when the total natural gas production for all of Kansas in 1982 was a little over 430 billion cubic feet (American Gas Association, *Gas Facts: 1984 Data* 28, 29 (1985)). The Kansas Commission found that this high underage level stemmed from the fact that pipelines were not willing to purchase the gas up to the allowable levels. Because of relatively liberal production and sales contracting terms and the higher tolerances for underproduction in the Kansas Hugoton field, pipelines were using that field for "storage" and filling their gas needs elsewhere first (J.S. App. 22a).

[3] The state regulations provide that if a well accumulates underages equal to six times its monthly allowable, the underages are cancelled. Until the 1983 amendment, such "cancelled underages" could be reinstated at any time that the well was in an overproduced status and had a ready purchaser (J.S. 5).

3. Appellants, with other interstate pipelines, participated before the Kansas Commission in the rulemaking preceding the rule change. They challenged the proposed rule change on the ground (inter alia) that it would unlawfully encroach upon the federal government's exclusive regulatory jurisdiction under the Natural Gas Act, 15 U.S.C. 717 *et seq.*[4] Appellants argued that cancelling underages would force them to purchase more Kansas gas at a time when they did not need the gas, and therefore that the state was in effect directing their purchasing practices, a matter exclusively the concern of the Federal Energy Regulatory Commission. See *Northern Natural Gas Co.* v. *State Corporation Commission*, 372 U.S. 84 (1963).

After the Kansas Commission rejected these contentions, appellants sought judicial review of the new rule. The Kansas district court upheld the new rule (J.S. App. 41a-48a) on the theory that it involved the "production or gathering" of gas, and thus was a legitimate state act specifically excluded from the ambit of federal regulation by Section 1(b) of the Natural Gas Act, 15 U.S.C. 717(b).

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[4] Most of the natural gas produced from the Kansas-Hugoton gas field is produced for and sold to interstate gas pipelines under certificates of public convenience and necessity issued by the Federal Power Commission (now the Federal Energy Regulatory Commission) under the Natural Gas Act (J.S. 3-4). This means that the gas is dedicated to interstate commerce and producers have a legal duty to sell their gas to the interstate market until relieved of that obligation by the Commission. Passage of the Natural Gas Policy Act of 1978 (NGPA), 15 U.S.C. 3301 *et seq.*, did not relieve producers from that obligation, because that Act specifically provides that gas flowing in interstate commerce before the NGPA was enacted generally remains under the Commission's Natural Gas Act authority (15 U.S.C. 3431(a)).

A divided Kansas Supreme Court affirmed (J.S. App. 4a-32a). While recognizing that the new rule had an "indirect effect to influence purchasers" and "even though purchasers are indirectly caught in the backwash," the majority upheld the rule against the challenge based on *Northern Natural* because the "rules on underages are a part of production regulation" over which the state has exclusive jurisdiction (J.S. App. 28a-29a). In dissent, Chief Judge Schroeder was of the view that the rule must fall, either on the ground that the Kansas Commission had exceeded its "statutory authority in fixing allowables far in excess of demand" (J.S. App. 33a), or alternatively, because the state regulation violated *Northern Natural*: while "directed at producers not purchasers, its real purpose is to create an impact on purchasers' business decisions concerning the makeup of their interstate gas mix" and therefore its effect is to impair the regulatory authority of the Commission under the Natural Gas Act (J.S. App. 34a-36a).

DISCUSSION

In *Northern Natural* this Court set aside state orders directing interstate gas pipelines to take gas ratably from Kansas wells under penalty of state law. In so ruling, the Court found that those orders "necessarily deal[t] with matters which directly affect the ability of the Federal Power Commission to regulate comprehensively and effectively the transportation and sales of natural gas, and to achieve the uniformity of regulation which was an objective of the Natural Gas Act." 372 U.S. at 91-92. In that case, interstate pipelines had been directed, under the threat of state imposed criminal sanctions, to change their purchasing practices to balance the out-

put of the state's wells. In that situation, the Court concluded that "although collision between the state and federal regulation may not be an inevitable consequence, there lurks such imminent possibility of collision in orders purposely directed at interstate wholesale purchasers that the orders must be declared a nullity in order to assure the effectuation of the comprehensive federal regulation ordained by Congress." 372 U.S. at 92.

The question of the continuing validity of *Northern Natural* is currently before this Court in *Transcontinental Gas Pipe Line Corporation* v. *State Oil and Gas Board of Mississippi (Transco)*, No. 84-1076 (argued Oct. 8, 1985). We there argued that *Northern Natural* has continued validity in today's natural gas regulatory system. This case, unlike *Northern Natural* and *Transco*, involves a state order directed at the gas producers, rather than their purchasers. If we are correct in our contention in *Transco*, the question remains whether this difference in the state order serves to avoid the preemptive effect of the federal scheme.

1. The state courts believed that it did. In holding that *Northern Natural* has no application to the Kansas Commission's rule change, the state courts deemed the dispositive consideration to be that the rules here at issue, even though "obviously intended for purchasers," are in terms "directed to producers" and thus constitute a lawful exercise of legitimate state authority over the "production or gathering of natural gas" (J.S. App. 28a-29a). In reaching this conclusion, the state courts thus apparently view *Northern Natural* as having drawn a bright line between the federal and state regulatory interests based on whether the state action addresses purchasers or producers.

At first blush, this is an inviting approach. State control over the production of mineral resources is, as long recognized by the Court, an important aspect of state authority not to be overturned on preemption grounds absent the establishment of a legitimate federal purpose.[5] See, *eg.*, *Champlin Refining Co.* v. *Corporation Commission*, 286 U.S. 210, 235 (1932) and cases there cited (upholding state proration orders applying only to the production and not to the sales or transportation of crude oil); see also *Thompson* v. *Consolidated Gas Utilities Corp.*, 300 U.S. 55, 69 (1937) (discussing the state's "undoubted power" to regulate gas production to prevent waste, and to create and protect correlative rights of owners of a common pool of gas against drainage). Indeed, in *Northern Natural* itself this Court recognized a "significant distinction" between "measures aimed directly at interstate purchasers and wholesale[r]s for resale [which are unlawful], and those aimed at producers and production" (372 U.S. at 94). The Natural Gas Act similarly recognizes this distinction in exempting from federal jurisdiction gas "production or gathering" (15 U.S.C. 717(b)).[6]

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[5] We do not agree with appellants' suggestion (J.S. 13-14) that the rule change cannot reasonably be viewed as designed to affect the conduct of producers, because they need no incentive to produce and sell gas. It would not have been unreasonable for the State Commission to conclude that under the original system, producers might prefer to postpone sales in the hope they would obtain a higher price for their product in the future.

[6] Appellants incorrectly suggest (J.S. 15 n.3) that a state's "production or gathering" authority under Section 1(b) of the Natural Gas Act, 15 U.S.C. 717(b), covers only physical activities such as gas well drilling, spacing and the like. See *Northern Natural*, 372 U.S. at 90; see also *Shell Oil Co.*

2. But, as this Court recognized in *Northern Natural*, the purposes underlying preemption in this area do not in fact permit such a simple, "bright line" analysis. Instead, as the Court there explained (372 U.S. at 91-92 (footnote and citation omitted)):

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v. *FERC*, 566 F.2d 536 (5th Cir. 1978), aff'd by an equally divided Court, 440 U.S. 192 (1979). The state rule here, which on its face is part of the state's general proration scheme ordering when and how gas can be produced (J.S. App. 51a), appears to fit squarely within the recognized area of regulation over the physical production of gas—*i.e.*, it determines how allowables may be exceeded at a given time to make up underages. Such state regulation through proration rules has long been viewed as regulating "production," not sales or transporation. *See Champlin Refining Co.* v. *Corporation Commission*, 286 U.S. 210, 235 (1932) (state proration rules impose no impermissible burden on interstate commerce). *United Gas Improvement Co.* v. *Continental Oil Co.*, 381 U.S. 392 (1965), upon which appellants rely, is not to the contrary. That case involved transactions the Court found to be "sale[s] of natural gas in interstate commerce" (381 U.S. at 402). It did not redefine the mutually exclusive spheres of state and federal jurisdiction demarked by the "production or gathering" exclusion of Section 1(b). Indeed, the Court's decision recognized that demarcation in noting that its decision "in no way interfer[ed] with state regulatory power over the physical processes of production or gathering in furtherance of conservation or other legitimate state concerns" (381 U.S. at 403).

The passage of the Natural Gas Policy Act did not alter this basic demarcation. As the legislative history of the NGPA makes clear, its passage "does not contemplate that FERC will intrude into the traditional conservation functions performed by the states * * * who, in the exercise of their historical powers, will continue to regulate such matters as drilling locations, completion techniques, *production rates*, etc." (124 Cong. Rec. 38366 (1978) (remarks of Rep. Dingell, House Manager of the NGPA) (emphasis added)).

> [t]he federal regulatory scheme leaves no room either for direct state regulation of the prices of interstate wholesales of natural gas, * * * or for state regulations which would indirectly achieve the same result. * * * [S]tate orders [that] necessarily deal with matters which directly affect the ability of the Federal Power Commission [now the Federal Energy Regulatory Commission] to regulate comprehensively and effectively the transportation and sale of natural gas, and to achieve the uniformity of regulation which was an objective of the Natural Gas Act * * * invalidly invade the federal agency's exclusive domain.

Appellants argue that the Kansas orders here are as inconsistent with federal regulation of interstate gas pipelines as the state scheme ruled invalid in *Northern Natural*, because the Kansas orders are designed to compel interstate pipelines to increase their takes of Kansas gas or lose forever their right to take such gas in the future (J.S. 7-8). Appellants contend that if they increase their Kansas takes, they must reduce their purchases from other producers, thereby incurring take-or-pay liability for the gas not taken and burdening their interstate customers with these added costs (J.S. 9, 16-18). On the other horn of the dilemma, they claim that if the gas is not taken now, their producers' underages could be permanently cancelled and gas originally destined for the interstate gas market customers could then effectively be diverted from appellants through drainage (J.S. 7 n.2). In sum, appellants' preemption claim rests on the assertion that interstate pipelines that exercise their contractual right to delay purchasing volumes of gas committed to them by their producers will lose the opportunity to buy that gas later (J.S. 16-18).

If appellants are correct, the state action cannot, we submit, stand under established preemption doctrine. As in *Northern Natural* the pipelines would effectively be required, under compulsion of state law, to change their purchasing practices to fit the parochial preferences of the state. This is the same conflict—or real possibility of conflict—between the state and federal schemes that required an otherwise valid state scheme to give way in *Northern Natural*, 372 U.S. at 94.[7] In such circumstances, it cannot be dispositive that the regulatory language used by the state is directed at gas production and producers. The inquiry instead must be whether the state action interferes with the federal scheme, no matter whether that interference is effectuated directly or indirectly.

Nor is it enough to save the state scheme merely to show that the challenged regulation serves a valid state interest. As this Court recognized in *Arkansas Louisiana Gas Co.* v. *Hall*, 453 U.S. 571, 584 (1981) (citation omitted):

> [e]very pre-emption case involves a conflict between a claim of right under federal law and a claim of right under state law. A finding that

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[7] Indeed, if the state's order would result in drainage of gas dedicated to interstate commerce (J.S. 7 n.2, 18-19), this would raise serious questions affecting the Federal Energy Regulatory Commission's authority apart from any consideration of pipeline purchasing practices (Gov't Br. at 12, *Transco*). Gas that is dedicated to interstate commerce may not be diverted from that commerce without Commission "abandonment" authorization under Section 7(b) of the Natural Gas Act, 15 U.S.C. 717f(b). See generally *United Gas Pipe Line Co.* v. *McCombs*, 442 U.S. 529, 542 (1979); *California* v. *Southland Royalty Co.*, 436 U.S. 519, 525-526 (1978); *Sunray Mid-Continent Oil Co.* v. *FPC*, 364 U.S. 137, 156 (1960).

> federal law provides a shield for the challenged conduct will almost always leave the state-law violation unredressed. * * * "[S]ince remedies form an ingredient of any integrated scheme of regulation * * * to allow the State to grant a remedy here which has been withheld [in the federal regulatory scheme] only accentuates the danger of conflict."
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> The same principle applies here. * * * No appeal to equitable principles can justify [the] usurpation of federal authority.

3. This case should be disposed of in light of this Court's decision in *Transco*. If the Court rejects our contentions in that case, it may so limit *Northern Natural* that the result reached by the courts below would clearly be correct. Otherwise, this case should be remanded to the State Supreme Court for additional findings and analysis. As we have explained, the courts below incorrectly read *Northern Natural* as providing a "bright line" test depending simply on whether the state regulation directly addresses interstate purchasers. This Court's decision in *Transco* will undoubtedly shed further light on this issue, and it is appropriate for the state courts to grapple in the first instance with the application of the principles to be laid down in *Transco* to the somewhat different facts of this case.

Moreover, neither the Kansas Commission nor the Kansas courts made findings that could be highly pertinent to the correct resolution of this case. We submit that the state may not lawfully compel interstate pipelines, on pain of suffering a legal or economic penalty, to become unwilling partners with Kansas in requiring increased production of Kansas gas. The record would arguably support a finding that the state rule change had an impermissible coercive effect on the pipelines—in this case, that they should change

their purchasing practices or risk forfeiting the right to purchase gas in the future.[8] Since neither the Kansas Commission nor the Kansas courts made such a finding,[9] however, it would not be appropriate

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[8] For example, while there was testimony before the Kansas Commission that the rule change would cause a loss of gas reserves (see, *e.g.*, 13 R. 544-547 (summarizing testimony)), but there was also contrary testimony (see 10 R. 179-180). The Kansas Commission's own expert testified on both sides of the question, declaring that cancelling underages would not mean losing reserves (9 R. 53) but might result in drainage (9 R. 86). There is no suggestion that the pipelines would forfeit gas that was already paid for; the controversy concerns only contractual rights to make future purchases.

[9] The only finding describing the effect of the rule change on the pipeline purchasers is that of the district court (J.S. App. 46a):

> [a]s a practical matter, the [rule] change * * * will cause some permanent loss of underages (allowables) due to market conditions and will also cause a change in the "mix" of natural gas which pipelines transport for sale many miles away.

The court leaves unanswered, however, the question whether the change in the pipelines' gas "mix" would result from pipelines being forced to purchase Kansas gas under the risk of losing contractual rights to take that gas at a future time. As the Kansas Supreme Court observed, the district court found "that the order would induce increased production" (J.S. App. 27a). Yet, there is no explanation of how or why this would happen.

Although appellants state (J.S. 7 n.2) that "it is clear that [loss of reserves] will occur with respect to a signficant number of wells in the Hugoton Field," their authority for this statement is simply a citation to those parts of the Kansas Supreme Court's opinion that summarize the appellants' contentions and their evidence; that court specifically declined to make any such finding, deferring instead to the Kansas Commission as the expert body. The dissent, also quoted by appellants, did not ground its conclusion regarding uncompensated drainage on any findings below. Compare J.S. App.

for this Court to atempt to make a finding concerning the effects of the rule change on the pipelines. It should instead, we submit, remand to the Kansas Supreme Court with directions that findings be made as to the effect of the rule.

This Court has made clear that "The exercise of federal supremacy is not lightly to be presumed." *New York Department of Social Services* v. *Dublino*, 413 U.S. 405, 413 (1973) (quoting *Schwartz* v. *Texas*, 344 U.S. 199, 202-203 (1952)); see also *Pacific Gas & Electric Co.* v. *State Energy Reserves Conservation & Development Comm'n*, 461 U.S. 190 (1983). This admonition has particular force in this case, in light of the statutory reservation to the States of authority over production and gathering.[10] We agree with the appellant that the States may not, under the guise of that authority, attempt to regulate the interstate market. But the mere existence of contracts committing gas to the interstate market does not deprive the States of the ability to modify, for proper allocation or conservation purposes, the legal rules governing production and gathering.

In sum, this Court should not, on this record, attempt to resolve the preemption issue in the context of complex state regulations dealing with gas conservation and production, "as thorny a problem as has

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38a (dissent) with J.S. App. 6a (majority summary of effects of order change, noting principle of compensating drainage, leading to increase in allowables for underproducing wells, as tending "to keep the wells in balance in the long pull").

[10] In contrast, the state regulations at issue in *Northern Natural* and *Transco* are addressed directly to the actions of interstate pipelines, whose activities are comprehensively subject to federal regulation. While, for the reasons noted above, we do not believe this difference is in itself dispositive, it may well justify a somewhat more deferential approach to state regulatory attempts in the instant case.

challenged the ingenuity and wisdom of legislatures" (*Railroad Commission* v. *Rowan & Nichols Oil Co.*, 310 U.S. 573, 579 (1940)).[11]

CONCLUSION

For the foregoing reasons, the appeal should be held pending this Court's decision in *Transco*, No. 84-1076, and disposed of as appropriate in light of that decision.

Respectfully submitted.

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[11] Appellants' contention (J.S. 20-23) that the amended state rule is inconsistent with the Commerce Clause is based on the same contentions as to the effect of that change that underlie their preemption claim (page 9, *supra*), and would similarly be illuminated by further findings. If the rule change is invalid on preemption grounds, it is unnecessary to consider the Commerce Clause claim. Cf. *Middle South Energy* v. *Arkansas Public Service Comm'n*, 772 F.2d 404, 411 (8th Cir. 1985) (disposing of case on Commerce Clause grounds, rather than addressing preemption claims). But if the state action is acceptable regulation of production, an area reserved by the federal statute to the states, with only a permissible incidental effect on interstate commerce, the Commerce Clause challenge necessarily fails. See *Pike* v. *Bruce Church, Inc.*, 397 U.S. 137, 142 (1970); *Champlin Refining Co.* v. *Corporation Commission*, 286 U.S. 210, 235 (1932).

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